Docket for 02-857

(12)

No. 02-857 Status: ARGUED
Title: Household Credit Services, Inc. and MBNA America Bank, N.A., Petitioners
v.
Sharon R. Pfennig
Docketed: December 6, 2002
Lower Ct: United States Court of Appeals for the Sixth Circuit
Case Nos.: (00-4213)
Decision Date: July 2, 2002
Rehearing Denied: September 3, 2002

| ~~~Date~~~ | ~~~~~~~~Proceedings and Orders~~~~~~~~~~~~~~~~~~~~~~~~ |
|---|---|
| Dec 2 2002 | Petition for writ of certiorari filed. (Response due January 6, 2003) |
| Dec 19 2002 | Order extending time to file response to petition to and including February 4, 2003. |
| Feb 4 2003 | Brief of respondent Sharon R. Pfenning in opposition filed. |
| Feb 4 2003 | Brief amici curiae of American Bankers Association, et al. filed. |
| Feb 12 2003 | Reply of petitioners Household Credit Services, Inc. et al. filed. |
| Mar 10 2003 | The Solicitor General is invited to file a brief in this case expressing the views of the United States. |
| May 30 2003 | Brief amicus curiae of United States filed. |
| Jun 27 2003 | Petition GRANTED. |
| Jul 14 2003 | Extension of time within which to file the joint appendix and petitioners' brief on the merits to and including August 18, 2003. |
| Aug 12 2003 | Motion to dispense with printed appendix filed by petitioners Household Credit Services. |
| Aug 18 2003 | Brief amicus curiae of United States filed. |
| Aug 18 2003 | Brief of petitioners Household Credit Services, Inc. and MBNA America Bank, NA filed. |
| Aug 18 2003 | Brief amici curiae of American Bankers Association, et al. filed. |
| Aug 18 2003 | Brief amicus curiae of William P. Schlenk filed. |
| Sep 16 2003 | Extension of time within which to file respondent's brief on the merits to and including September 29, 2003. |
| Sep 17 2003 | Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed. |
| Sep 29 2003 | Brief of respondent Sharon R. Pfenning in opposition filed. |
| Oct 6 2003 | Motion to dispense with printed appendix filed by petitioner GRANTED. |
| Nov 3 2003 | Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED. |
| Nov 3 2003 | Reply of petitioner Household Credit Services filed. |
| Dec 10 2003 | SET FOR ARGUMENT Monday February 23, 2004. |
| Dec 17 2003 | CIRCULATED. |
| Jan 5 2004 | Record received from the U.S.C.A. for the 6th Circuit. (1 binder) |
| Jan 16 2004 | Record received from the U.S.D.C. for the Southen District of Ohio. (envelope) |
| Feb 23 2004 | Argued. For petitioners: Seth P. Waxman, Washington, D.C., and on behalf of the United States, as amicus curiae, Barbara B. McDowell, Assistant to the Solicitor General, Department of Justice, Washington, D.C. For respondent: Sylvia A. Goldsmith, Sandusky, Ohio. |

No. (1)

Supreme Court, U.S.
FILED

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 2002

HOUSEHOLD CREDIT SERVICES, INC.
and MBNA AMERICA BANK, N.A.,

*Petitioners,*

—v.—

SHARON R. PFENNIG,

*Respondent.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

## PETITION FOR A WRIT OF CERTIORARI

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81-P

## Question Presented

In enacting the Truth in Lending Act, Congress delegated expansive authority to the Federal Reserve Board to issue implementing regulations. The Act provides that "these regulations may contain such classifications . . . as in the judgment of the Board are necessary" to effectuate the purposes of the statute. 15 U.S.C. § 1604(a). The Federal Reserve exercised this authority by promulgating Regulation Z, a provision of which has since 1981 excluded from the definition of "finance charge" any fees imposed "for exceeding a credit limit." 12 C.F.R. § 226.4(c)(2). In *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 565 (1980), this Court held that the Federal Reserve's interpretations of the Truth in Lending Act are dispositive unless "demonstrably irrational." A divided panel of the Sixth Circuit nevertheless invalidated the Federal Reserve's classification of over-limit fees, holding that Regulation Z's exclusion of such fees from the finance charge conflicts with the Act's general definition of "finance charge." The question presented for review is:

> Whether the Sixth Circuit improperly substituted its interpretation of the Truth in Lending Act for that of the Federal Reserve—the agency authorized by Congress to interpret the statute—in invalidating an important provision of Regulation Z that affects tens of millions of consumer credit card agreements.

## List of Parties and Rule 29.6 Statement

The caption of the case contains the names of all the parties to the proceedings before the United States Court of Appeals for the Sixth Circuit.

The parent company of petitioner Household Credit Services, Inc. is Household Finance Corporation, which is a wholly owned subsidiary of Household International, Inc. The parent company of petitioner MBNA America Bank, N.A. is MBNA Corporation. No other publicly held company owns 10% or more of the stock of either petitioner.



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IN THE

# Supreme Court of the United States

OCTOBER TERM, 2002

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HOUSEHOLD CREDIT SERVICES, INC. and
MBNA AMERICA BANK, N.A.,

*Petitioners*,

v.

SHARON R. PFENNIG,

*Respondent*.

---

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

---

Petitioners respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit.

### Opinions Below

The Court of Appeals' opinion is reported at 295 F.3d 522 and reprinted at pages A1-23. The District Court's opinion is unreported and reprinted at pages A24-29.

### Jurisdiction

The Court of Appeals entered its judgment on July 2, 2002. A timely petition for rehearing was denied on September 3, 2002. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

### Statute and Regulation Involved

This case involves the following provisions of the Truth in Lending Act:

> The Board shall prescribe regulations to carry out the purposes of this subchapter. Except in the case of a mortgage referred to in section 1602(aa) of this title, these regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this subchapter, to prevent circumvention or evasion thereof, or to facilitate compliance therewith.

15 U.S.C. § 1604(a).

> Except as otherwise provided in this section, the amount of the finance charge in connection with any consumer credit transaction shall be determined as the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit. The finance charge does not include charges of a type payable in a comparable cash transaction. The finance charge shall not include fees and amounts imposed by third party closing agents (including settlement agents, attorneys, and escrow and title companies) if the creditor does not require the imposition of the charges or the services provided and does not retain the charges. Examples of charges which are included in the finance charge include any of the following types of charges which are applicable:
>
> (1) Interest, time price differential, and any amount payable under a point, discount, or other system of additional charges.
>
> (2) Service or carrying charge.
>
> (3) Loan fee, finder's fee, or similar charge.
>
> (4) Fee for an investigation or credit report.
>
> (5) Premium or other charge for any guarantee or insurance protecting the creditor against the obligor's default or other credit loss.



> (6) Borrower-paid mortgage broker fees, including fees paid directly to the broker or the lender (for delivery to the broker) whether such fees are paid in cash or financed.

15 U.S.C. § 1605(a).

This case also involves the following provision of Regulation Z, which implements the Truth in Lending Act:

> The following charges are not finance charges: . . .
> (2) Charges for actual unanticipated late payment, for exceeding a credit limit, or for delinquency, default, or a similar occurrence.

12 C.F.R. § 226.4(c)(2).

## Statement of the Case

A divided panel of the Sixth Circuit invalidated an important provision of Regulation Z, 12 C.F.R. Part 226, the regulations issued by the Federal Reserve to implement the Truth in Lending Act ("TILA"), 15 U.S.C. § 1601 *et seq*. TILA promotes informed use of consumer credit by providing uniform disclosures to consumers about the costs and terms of credit. The decision below raises an issue of federal law that is of exceptional importance to the credit card industry, the Federal Reserve's ability to promulgate implementing regulations, and the administration of TILA nationwide. At a minimum, the Court should call for the views of the Solicitor General.

### A. The Relevant Statute and Regulation

The issue in this case is whether TILA requires that over-limit fees (*i.e.*, fees imposed on credit card holders for exceeding their credit limits) be included in the "finance charge" shown on cardholders' periodic statements or be disclosed separately on such statements as "other charges." TILA generally defines a "finance charge" as "the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by

the creditor as an incident to the extension of credit." 15 U.S.C. § 1605(a). The statute specifies six categories of charges that must be included in the finance charge. *Id.* § 1605(a)(1)-(6). TILA is silent, however, on the precise question of whether over-limit fees must be included.

Congress delegated expansive authority to the Federal Reserve to "prescribe regulations to carry out the purposes of" TILA. *Id.* § 1604(a). "[T]hese regulations may contain such classifications, differentiations, or other provisions . . . as in the judgment of the Board are necessary or proper to effectuate the purposes" of TILA. *Id.* Pursuant to this authority, the Federal Reserve promulgated Regulation Z, which establishes uniform disclosure rules for creditors and fills in certain gaps left by TILA. Since 1981, Regulation Z has excluded from the definition of "finance charge" any fees imposed "for exceeding a credit limit." 12 C.F.R. § 226.4(c)(2). The Federal Reserve issued this regulation after notice and public comments pursuant to the Administrative Procedure Act, 5 U.S.C. § 551 *et seq.* In *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 565 (1980), this Court held that Federal Reserve regulations construing TILA are dispositive unless "demonstrably irrational."

### B. Proceedings in the District Court

Respondent holds a credit card issued by an affiliate of petitioner Household Credit Services, Inc. and later acquired by petitioner MBNA America Bank, N.A. Petitioners charged respondent an over-limit fee for exceeding the credit limit applicable to her account. In accordance with Regulation Z, petitioners did not include this fee in the finance charge, but rather disclosed the fee separately in the section of respondent's periodic statement detailing recent account activity.

Respondent filed this action in the United States District Court for the Southern District of Ohio, seeking declaratory and injunctive relief as well as damages on behalf of a putative class of cardholders. She claims that petitioners violated TILA by not including the over-limit fee in the finance charge. The District Court had subject matter jurisdiction under 15 U.S.C. § 1640(e) and 28 U.S.C. § 1331.



Because Regulation Z expressly excludes over-limit fees from the definition of finance charge, petitioners moved to dismiss the complaint for failure to state a claim pursuant to Federal Rule of Civil Procedure 12(b)(6). Petitioners also argued that they are immune from damages under 15 U.S.C. § 1640(f) because they relied in good faith on Regulation Z.

The District Court dismissed the complaint, holding that "in light of the plain language of Regulation Z, the 'over-limit fee' at issue in this case is not a finance charge" under TILA. (A27) Relying on this Court's *Milhollin* decision, the court stated "that it must give deference to the Federal Reserve Board's statutory interpretation of the term finance charge." (A28) The court explained:

> Regulation Z at Section 226.4(c)(2) excludes several categories of charges, all of which arise when the terms under which the credit was extended have been breached by the borrower. These categories include the making of unanticipated late payments or the exceeding of a credit limit . . . . All of these post-credit extension occurrences are done in violation of the agreed upon terms upon which the credit was extended. Such charges are never imposed upon a borrower who simply follows the terms of the agreement. The Federal Reserve Board rationally determined that these charges, for acts amounting to breaches of the agreed upon credit extension, are not finance charges.

(A28)

### C. The Court of Appeals' Decision

A divided panel of the Sixth Circuit reversed in part and affirmed in part. Over a dissent, the court held that Regula-

tion Z's exclusion of over-limit fees from the finance charge is invalid because it conflicts with TILA's general definition of "finance charge." Giving TILA "a liberal interpretation in favor of consumers" (A8), the court determined, based on respondent's allegation that petitioners "permitted her to exceed her original credit limit" (A12), that the over-limit fee in this case "was imposed incident to the extension of credit" and thus falls "within the statutory definition of the 'finance charge'" (A19). Rejecting the Federal Reserve's classification, the Sixth Circuit substituted its own highly factual test, concluding that over-limit fees must be included in the finance charge whenever a creditor "knowingly" permits the credit card holder to exceed the credit limit. (A15 n.5)

The court nevertheless concluded that petitioners are immune from damages under 15 U.S.C. § 1640(f) because they relied in good faith on Regulation Z. (A15-18) The court thus affirmed the dismissal of the complaint to the extent it seeks damages, but held that respondent may proceed with her claim for injunctive and declaratory relief. (A19)

Chief Judge Edgar of the United States District Court for the Eastern District of Tennessee, sitting by designation, dissented from the part of the opinion that invalidated the relevant provision of Regulation Z. Noting that over-limit fees "are nowhere mentioned" in TILA's definition of finance charge (A20), Judge Edgar observed that the majority had improperly substituted its interpretation of TILA for that of the Federal Reserve in contravention of *Milhollin*:

> The majority's interpretation of § 1605(a) might well be a reasonable one; but so is that of the Federal Reserve Board. Certainly it cannot be said that the Federal Reserve's exclusion of over-limit charges from the finance charge in Regulation Z is demonstrably irrational. The Federal Reserve merely filled in a blank left by Congress in the TILA . . . .

(A22)



Judge Edgar warned that the majority's decision will undermine the uniform disclosure rules created by Regulation Z: "The majority's conclusion in this case effectively amends Regulation Z in this circuit. The national uniformity established by the Federal Reserve Board for consumer credit is thereby breached." (A22-23) Judge Edgar also criticized the majority for substituting a highly fact-bound test for the bright-line classification created by Regulation Z:

> [Under the majority decision,] credit card issuers must only disclose an over-limit fee when they have been made aware that an over-limit charge is pending approval, and they then permit the charge to go through. Thus some card issuers may be required to disclose under some circumstances, while others may not. This merely adds to lack of uniformity and confusion.

(A23 n.1)

Petitioners filed a petition for rehearing. The Federal Reserve filed an *amicus* brief in support of that petition, as did the American Bankers Association, the Consumer Bankers Association, the American Financial Services Association, MasterCard International Incorporated and Visa U.S.A. Inc. These *amici* emphasized not only the conflict between the panel's decision and *Milhollin*, but also the exceptional importance of the case. The Federal Reserve stated: "This case is of exceptional importance in that the panel decision nullifies an agency rule that implements a complex statute affecting creditors and consumers nationwide. The case is likely to affect the credit card industry in circumstances that are much broader than the facts cited by the panel majority." (A43) The other *amici* stressed: "The decision, if allowed to stand, will have an enormous impact on the credit card industry . . . ."

In explaining why it classified over-limit fees as not part of the finance charge, the Federal Reserve stated: "The Board's rule excluding over-limit fees from the finance

charge is based on the rational assumption that the fees are imposed when the consumer uses the credit plan in a manner that violates the terms of the plan." (A46) "Based on the rule, consumers can use uniform disclosures to compare the cost of credit card programs offered by different creditors that do not account for contingent costs that may be imposed under each plan for unanticipated events such as late payments or over-limit situations." (A46)

The Federal Reserve also stated that the Sixth Circuit's interpretation of TILA was predicated on a misunderstanding of the operation of the credit card system:

> [T]he panel majority erred in assuming that merely because the creditor allegedly authorized a proposed credit transaction that ultimately contributed to the account balance exceeding the cardholder's pre-approved credit limit, the creditor in effect had "renegotiated the [credit card] agreement" and "knowingly" agreed to extend additional credit to the cardholder in excess of the prior limit in return for the fee.

(A47-48) The Federal Reserve explained that "it cannot be determined with complete accuracy at [the time of a transaction] whether the account balance actually exceeds the credit limit." (A49) Thus, "creditors generally do not deny authorization on the mere suspicion that a transaction would cause the account balance to exceed the consumer's credit limit." (A50) They instead "typically determine whether to impose the fee only at the end of the billing cycle, when it can be determined that all charges and credits to the account establish that the consumer is in fact over the credit limit, and when other factors . . . may be taken into account." (A50)

As a matter of practice, the Federal Reserve stated, over-limit fees are imposed "only when consumers actually exceed the pre-established credit limit for some period of time, in order to impose discipline on consumer credit usage and to compensate the creditor for the added credit risk



involved." (A50) In light of this practice, the Federal Reserve has concluded that "the over-limit fee is more akin to other charges—such as late fees—that are not finance charges because they are not incident to a particular extension of credit." (A51)

According to the Federal Reserve, "the practical implications" of the Sixth Circuit's decision will be severe for credit card issuers that operate nationally:

> The panel decision, if permitted to stand, would create serious difficulties for national credit card companies that would comply with the language of Regulation Z outside of the Sixth Circuit and must comply with the separate rule adopted by the panel within the Sixth Circuit. Even within the Sixth Circuit alone, compliance could cause substantial confusion on the part of consumers, because under the rule enunciated by the panel, some over-limit fees would be included in, and disclosed as, finance charges while others would not.

(A51-52 (footnotes omitted))

The Sixth Circuit denied the petition for rehearing, expressly refusing to consider the Federal Reserve's discussion "of the actual operation of the credit card industry" or its explanation of the rationale for excluding over-limit fees from the finance charge. (A10 n.2)

**Reasons for Granting the Petition**

The Sixth Circuit erroneously invalidated a provision of Regulation Z. Indeed, the error below is so clear and its practical implications for the credit card industry are so severe that summary reversal is appropriate.

TILA does not address the precise question of whether over-limit fees must be included in the finance charge. In 1981, the Federal Reserve filled this gap by amending Regulation Z to exclude over-limit fees from the finance charge. TILA expressly authorizes the Federal Reserve to

make such classifications, 15 U.S.C. § 1604(a), and this Court has held that the Federal Reserve's interpretations of TILA are dispositive unless demonstrably irrational. *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 565 (1980).

The Sixth Circuit's decision is contrary to this Court's *Milhollin* decision, ignores the Federal Reserve's express authority to make "classifications," and conflicts with decisions of other courts of appeals broadly deferring to the Federal Reserve's interpretations of TILA.

The question presented here warrants immediate review. By effectively amending Regulation Z in the Sixth Circuit, the decision below undermines the national uniformity that Congress sought to achieve by enacting TILA and delegating expansive authority to the Federal Reserve to issue implementing regulations. Absent a ruling by this Court, creditors will be faced with conflicting disclosure obligations—one set of obligations in the Sixth Circuit and another in the rest of the country, where creditors must continue to comply with Regulation Z as written.

The Sixth Circuit's rejection of the clear and easily enforced classification established by Regulation Z also will create immediate compliance problems for creditors. Under the Sixth Circuit's rule, some over-limit fees will be included in the finance charge and others will not, depending on whether the creditor "knowingly" permitted the cardholder to exceed the credit limit. This rule will create confusion, add to the lack of uniformity, and make it more difficult for consumers to compare the costs of credit.

## I. The Decision Below Is Contrary to This Court's *Milhollin* Decision and Conflicts with Decisions of Other Courts of Appeals.

In *Milhollin*, the Court held that the Federal Reserve's interpretations of TILA are dispositive unless "demonstrably irrational," an extraordinarily deferential standard. 444 U.S. at 565. Indeed, this Court recognized long ago that Congress



"delegated to the Federal Reserve Board broad authority to promulgate regulations necessary to render [TILA] effective." *Mourning* v. *Family Publ'n Serv., Inc.*, 411 U.S. 356, 365 (1973). In concluding in 1973 that the Federal Reserve had not exceeded its statutory authority in promulgating a particular provision of Regulation Z, the Court "held that where reasonable minds may differ as to which of several remedial measures should be chosen, courts should defer to the informed experience and judgment of the agency to whom Congress delegated appropriate authority." *Id.* at 371-72. Thus, "absent some obvious repugnance to the statute, the Board's regulation implementing [TILA] should be accepted by the courts." *Anderson Bros. Ford* v. *Valencia*, 452 U.S. 205, 219 (1981).

The *Milhollin* decision discusses at length the "high degree of deference" owed to the Federal Reserve. 444 U.S. at 557. Although courts generally should be "attentive[] to the views of the administrative entity appointed to apply and enforce a statute," the Court stated that such "deference is especially appropriate in the process of interpreting the Truth in Lending Act." *Id.* at 565. The Court explained:

> Because of their complexity and variety . . . , credit transactions defy exhaustive regulation by a single statute. Congress therefore delegated expansive authority to the Federal Reserve Board to elaborate and expand the legal framework governing commerce in credit.

*Id.* at 559-60. In holding that the Federal Reserve's interpretations of TILA are dispositive unless "demonstrably irrational," *id.* at 565, the Court relied on several factors.

First, the Court found that jurisprudential considerations require broad deference to the Federal Reserve. The "traditional acquiescence in administrative expertise is particularly apt under TILA," the Court stated, because the Federal Reserve "has played a pivotal role in setting [the statutory] machinery in motion." *Id.* at 566 (internal quotation omit-

ted). The Court stressed that TILA "is best construed by those who gave it substance in promulgating regulations thereunder." *Id.*

Second, the Court pointed to clear evidence of congressional intent:

> Congress has specifically designated the Federal Reserve Board and staff as the primary source for interpretation and application of truth-in-lending law. Because creditors need sure guidance through the "highly technical" Truth in Lending Act, legislators have . . . acted to promote reliance on Federal Reserve Board pronouncements.

*Id.* (citation omitted). The Court noted that TILA's creation of immunity from damages based on reliance on the Federal Reserve's interpretations "signals an unmistakable congressional decision to treat administrative rulemaking and interpretation under TILA as authoritative." *Id.* at 567-68. The Court emphasized that judges "should honor that congressional choice" and "refrain from substituting their own interstitial lawmaking for that of the Federal Reserve, so long as the latter's lawmaking is not irrational." *Id.* at 568.

Third, the Court concluded that broad deference to the Federal Reserve is compelled by necessity: "[A] court that tries to chart a true course to the Act's purpose embarks upon a voyage without a compass when it disregards the agency's views." *Id.* The Court explained that fulfilling the purposes of TILA is "an empirical process that entails investigation into consumer psychology and that presupposes broad experience with credit practices." *Id.* at 568-69. As the Court recognized, "[a]dministrative agencies are simply better suited than courts to engage in such a process." *Id.* at 569.

Applying this standard, the Court held that the court of appeals "erred in rejecting the views" of the Federal Reserve:



> Faced with an apparent lacuna in the express prescriptions of TILA and Regulation Z, the Court of Appeals had no ground for displacing the Federal Reserve staff's expert judgment.

*Id.* at 570.[1]

In accordance with *Milhollin*, other courts of appeals, unlike the Sixth Circuit, have accorded a high degree of deference to the Federal Reserve's interpretations of TILA. *See, e.g.*, *Riviere* v. *Banner Chevrolet, Inc.*, 184 F.3d 457, 460 (5th Cir. 1999) ("When it enacted TILA, Congress delegated expansive authority to the Federal Reserve Board to elaborate and expand the legal framework governing commerce in credit.") (internal quotation omitted); *Benion* v. *Bank One, Dayton, N.A.*, 144 F.3d 1056, 1059 (7th Cir.) ("When an activity of a technical and specialized character is comprehensively regulated by an expert agency, as consumer credit disclosures are comprehensively regulated by the Federal Reserve Board (and no one doubts that this particular agency is a repository of genuine expertise), courts should generally leave the plugging of loopholes to the agency, lest the court's reparative efforts create confusion and disrupt the regulatory scheme."), *cert. denied*, 525 U.S. 963 (1998); *Ortiz* v. *Rental Mgmt., Inc.*, 65 F.3d 335, 341 (3d Cir. 1995) ("We therefore cannot say that the Board's adoption of one of two plausible interpretations of the gap in the statute is demonstrably irrational."); *Sentinel Fed. Sav. & Loan Ass'n* v. *Office of Thrift Supervision*, 946 F.2d 85, 89 (8th Cir. 1991) ("These Supreme Court cases make it abundantly clear that Sentinel's attack on the validity of the Official Staff Commentary must fail unless Sentinel can show that the composite annual percentage rate disclosure requirement was 'demonstrably irrational.'").

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[1] *Milhollin* involved Federal Reserve staff opinions interpreting TILA and Regulation Z. The degree of deference due to provisions of Regulation Z itself, promulgated by the Federal Reserve after notice and public comments, is at least as great.

In rejecting the Federal Reserve's classification of over-limit fees, the Sixth Circuit did not find that the regulation is irrational. Nor did the court find that Congress has "directly addressed the precise question at issue." *Chevron, U.S.A., Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843 (1984). To the contrary, as Judge Edgar noted in his dissent, over-limit fees "are nowhere mentioned" in TILA's definition of finance charge. (A20) Faced with such legislative silence, the Sixth Circuit had no ground for displacing the Federal Reserve's expert judgment that this statutory gap should be filled by a uniform classification excluding over-limit fees from the finance charge.

Contrary to this Court's decision in *Milhollin*, the Sixth Circuit rejected the Federal Reserve's classification based on its own determination that TILA's general definition of finance charge includes over-limit fees. TILA expressly contemplates, however, that credit cards may impose, in addition to the finance charge, "other charges" that must be disclosed separately. 15 U.S.C. §§ 1637(a)(3) & (5). As a result, not every fee associated with the extension of credit is considered part of the finance charge. Under the scheme created by Congress, the Federal Reserve is responsible for providing creditors with guidance as to whether particular charges not expressly addressed by TILA are "finance charges" or "other charges." In fulfilling this responsibility, the Federal Reserve is authorized to make such "classifications" as in its judgment are necessary to effectuate the purposes of TILA. *Id.* § 1604(a).

Under Regulation Z, over-limit fees—together with other fees generally imposed for violations of the account agreement (*e.g.*, late fees and default fees)—must be disclosed upon the opening of an account and on periodic statements as "other charges." *See* 12 C.F.R. §§ 226.6(b), 226.7(h). The Federal Reserve's conclusion that over-limit fees should be disclosed separately as "other charges," and not included in the finance charge, is not irrational. The fact that both Judge



Edgar and the district court in this case determined that the Federal Reserve's interpretation of TILA is reasonable cannot be reconciled with the majority's conclusion that TILA unambiguously requires that over-limit fees be included in the finance charge. *See Smiley* v. *Citibank (S.D.), N.A.*, 517 U.S. 735, 739 (1996) (noting that "it would be difficult indeed to contend that the word 'interest' in the National Bank Act is unambiguous" in light of dissenting opinions below and conflicting decision of another court).

In rejecting the Federal Reserve's statutory interpretation, the Sixth Circuit stressed that TILA "must be given a liberal interpretation in favor of consumers." (A8) This was not a legitimate basis, however, for ignoring the Federal Reserve's expert judgment about how best to protect consumers. Nor was it a legitimate basis for failing faithfully to apply the highly deferential standard of review set out in *Milhollin*. In *Ortiz*, the Third Circuit rejected a similar challenge to a provision of Regulation Z that was based on the claim that the Federal Reserve's statutory interpretation was "presumptively unreasonable because it does not have the effect of protecting consumers." 65 F.3d at 340. The Third Circuit found "no authority for the proposition that the Board must decide every conceivable question, even detailed and technical ones, in favor of expanding the scope of the TILA." *Id.* Rather, the court stated, "the Board has broad discretion to draw the lines necessary to effectuate the act." *Id.* at 340-41. The court upheld the challenged regulation because it could not "say that the Board's adoption of one of two plausible interpretations of the gap in the statute is demonstrably irrational." *Id.* at 341.

In enacting TILA, Congress sought to ensure "a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him." 15 U.S.C. § 1601. "[W]hat constitutes meaningful disclosure under TILA" is "exactly the sort of Board determination" to which courts "must grant a great deference

in the absence of an explicit statutory command." *Consumers Union of U.S., Inc.* v. *Fed. Reserve Bd.*, 938 F.2d 266, 270 (D.C. Cir. 1991). Here, the Federal Reserve concluded that consumers are better able to compare the costs of credit if over-limit fees are separately disclosed and not included in the finance charge. Indeed, including over-limit fees in the finance charge would often result in a sharp and potentially misleading increase in the annual percentage rate shown on periodic statements, making it *more* difficult for consumers to compare the costs of credit.

The decision below will require the Federal Reserve and creditors to engage in a series of case-specific factual inquiries to determine whether a given over-limit fee should be included in the finance charge. The Sixth Circuit's conclusion that TILA requires such case-by-case determinations flies in the face of the Federal Reserve's express statutory authority to make "classifications" necessary to effectuate the purposes of TILA. 15 U.S.C. § 1604(a). The Federal Reserve concluded that a uniform classification of over-limit fees (and other fees generally imposed when the consumer violates the terms of the credit plan) as other charges, and not finance charges, best serves the purposes of TILA.[2]

The Sixth Circuit rejected the Federal Reserve's classification based on a misunderstanding of how the credit card system works. In denying a petition for rehearing, the Sixth Circuit expressly refused to consider the Federal Reserve's discussion "of the actual operation of the credit card industry." (A10 n.2) By disregarding the views of the Federal Reserve and trying to chart its own "course to the Act's purposes," the Sixth Circuit "embark[ed] upon a voyage without a compass." *Milhollin*, 444 U.S. at 568. As this Court has observed, "the judgments about the way the

[2] The legislative history of TILA recognizes that over-limit fees generally "accrue for misuse of the account." S. REP. NO. 100-259, at 6 (1987), *reprinted in* 1988 U.S.C.C.A.N. 3936, 3942.



real world works that have gone into the [agency's interpretation of the statute] are precisely the kind that agencies are better equipped to make than are courts. *Pension Benefit Guar. Corp.* v. *LTV Corp.*, 496 U.S. 633, 651 (1990).

## II. The Question Presented Is Important and Warrants Immediate Review by This Court.

As leading commentators have noted, issues involving "the validity of agency regulations under the statutes pursuant to which they were promulgated" are often sufficiently important to warrant this Court's review. ROBERT L. STERN ET AL., SUPREME COURT PRACTICE § 4.13, at 248 (8th ed. 2002). In fact, this Court has granted certiorari in numerous cases involving the validity of agency rules or regulations, even in the absence of a direct conflict among the circuits. *See, e.g., Pub. Lands Council* v. *Babbitt*, 529 U.S. 728, 739 (2000) (reviewing decision that sustained regulations promulgated by the Secretary of Interior under the 1934 Taylor Grazing Act); *AT&T* v. *Iowa Utils. Bd.*, 525 U.S. 366, 375-77 (1999) (reviewing decision that invalidated Federal Communications Commission rules under the Telecommunications Act of 1996).

The Sixth Circuit's decision raises just such an important issue. Moreover, allowing this decision to stand will have immediate deleterious consequences for both creditors and consumers. This Court thus should grant certiorari now without waiting for a more pronounced circuit split to emerge.

First, the decision below creates serious regulatory and compliance problems for the Federal Reserve and the credit card industry because it creates conflicting disclosure obligations. As Judge Edgar noted, "[t]he majority's conclusion in this case effectively amends Regulation Z in this circuit. The national uniformity established by the Federal Reserve Board for consumer credit is thereby breached." (A22-23) The Federal Reserve underscored this problem in its *amicus* brief below: "The panel decision, if permitted to stand, would

create serious difficulties for national credit card companies that would comply with the language of Regulation Z outside of the Sixth Circuit and must comply with the separate rule adopted by the panel within the Sixth Circuit." (A51)[3] According to the Federal Reserve, these "differing and conflicting standards will apply in an area in which uniform disclosure of credit costs is of utmost importance in effectuating the purposes of the statute." (A43) Without uniform disclosures, consumers cannot effectively compare the costs of credit available to them. *See* H.R. REP. NO. 1040 (1967), *reprinted in* 1968 U.S.C.C.A.N. 1962, 1975 ("[F]or uniformity of application to all affected segments of the industries concerned, a single set of comprehensive regulations should be issued."). Only review by this Court can restore the uniformity that Congress intended and that creditors and consumers require.

Second, the decision below requires the Federal Reserve to abandon its uniform classification in favor of a fact-specific test that will be difficult to apply and will create confusion among consumers. Under the Sixth Circuit rule, an over-limit fee must be included in the finance charge if "the creditor knowingly permit[ted] the credit card holder to exceed his or her credit limit." (A15 n.5) "Thus some card issuers may be required to disclose under some circumstances, while others may not." (A23 n.1) As Judge Edgar observed, "[t]his merely adds to lack of uniformity and confusion," making it more difficult for consumers to understand and compare credit terms. (A23 n.1) The Federal Reserve shared this concern:

[3] A creditor attempting to comply nationwide with the Sixth Circuit's rule would run the risk that another circuit would require it to comply with Regulation Z as written. Under such circumstances, the creditor might not be entitled to immunity from damages under 15 U.S.C. § 1640(f) based on its reliance on the Sixth Circuit's rule.



> Even within the Sixth Circuit alone, compliance could cause substantial confusion on the part of consumers, because under the rule enunciated by the panel, some over-limit fees would be included in, and disclosed as, finance charges, while others would not.

(A51-52)[4] Once again, only review by this Court can eliminate such compliance problems and consumer confusion.

The question presented is ripe for review. On remand, the focus will be whether petitioners "knowingly" permitted respondent to exceed her credit limit. Of course, the virtue of a bright-line classification is that it can be applied in a straightforward manner as a matter of law, rendering such case-specific factual inquiries unnecessary. In addition, the record developed on remand in connection with respondent's claim for injunctive and declaratory relief will relate primarily to respondent's account with petitioners and thus will be of little or no assistance to the Court in addressing the broader question of whether the Federal Reserve's classification of over-limit fees is rational, the relevant inquiry under *Milhollin*. In the meantime, petitioners and other credit card issuers must begin to implement an inconsistent system of disclosures—one in the Sixth Circuit and another elsewhere.

The petition presents an important and clear-cut issue of law. There is no reason to let the issue "percolate," particularly because the decision below is clearly incorrect under *Milhollin*. To the contrary, there are compelling reasons to grant certiorari now and summarily reverse.

[4] In the Sixth Circuit, a creditor could not simply elect to treat *all* over-limit fees as finance charges. Under the decision, such fees constitute finance charges only if the creditor "knowingly" permits the cardholder to exceed the credit limit. (A15 n.5)

**Conclusion**

The petition for a writ of certiorari should be granted. If the Court wishes to consider the views of the United States before acting on the petition, it should invite the Solicitor General to file an *amicus* brief.

Respectfully submitted,

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December 2, 2002

# APPENDIX

**UNITED STATES COURT OF APPEALS**

FOR THE SIXTH CIRCUIT

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| | |
|---|---|
| SHARON R. PFENNIG,<br>*Plaintiff-Appellant,* | |
| | No. 00-4213 |
| *v.* | > |
| HOUSEHOLD CREDIT SERVICES, INC., AND MBNA AMERICA BANK, N.A.,<br>*Defendants-Appellees.* | |

Appeal from the United States District Court
for the Southern District of Ohio at Columbus.
No. 99-00815—Edmund A. Sargus, Jr., District Judge.

Argued: November 27, 2001

Decided and Filed: July 2, 2002

Before: CLAY and GILMAN, Circuit Judges; EDGAR, Chief District Judge*.

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**COUNSEL**

**ARGUED:** Sylvia M. Antalis, MURRAY & MURRAY, Sandusky, Ohio, for Appellant. William G. Porter II, VORYS, SATER, SEYMOUR & PEASE, Columbus, Ohio, Richard C. Pepperman II, SULLIVAN & CROMWELL, New York, New York, for Appellees. **ON BRIEF:** Sylvia

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* The Honorable R. Allan Edgar, Chief United States District Judge for the Eastern District of Tennessee, sitting by designation.

M. Antalis, John T. Murray, MURRAY & MURRAY, Sandusky, Ohio, for Appellant. William G. Porter II, John J. Todor, VORYS, SATER, SEYMOUR & PEASE, Columbus, Ohio, Richard C. Pepperman II, Sharon L. Nelles, SULLIVAN & CROMWELL, New York, New York, David W. Alexander, SQUIRE, SANDERS & DEMPSEY, Columbus, Ohio, for Appellees.

CLAY, J., delivered the opinion of the court, in which GILMAN, J., joined. EDGAR, D. J. (pp. 19-22), delivered a separate opinion dissenting in part and concurring in part.

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**AMENDED OPINION**

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CLAY, Circuit Judge. Plaintiff, Sharon R. Pfennig, appeals from the district court's September 1, 2000 order dismissing her complaint in which she seeks to bring a class action against Defendants, Household Credit Services, Inc. ("Household") and MBNA America Bank, N.A. ("MBNA"), for alleged violations of the federal Truth in Lending Act ("TILA" or "Act"), 15 U.S.C. § 1601, *et seq.* Plaintiff alleges that Defendants extended her credit and then charged her a fee for doing so without properly disclosing that fee as a finance charge as required by TILA. The district court dismissed Plaintiff's complaint, determining that regulations promulgated by the Federal Reserve Board ("FRB"), which exclude over-limit fees from the definition of "finance charges," barred her claims. We now **AFFIRM** in part, **REVERSE** in part, and **REMAND**.

**BACKGROUND**

Plaintiff holds a credit card originally issued by an affiliate of Defendant Household in 1993, but in which MBNA acquired the interest in 1998, when MBNA bought Household's credit card portfolio. Defendants originally established Plaintiff's credit limit at $2,000, and



subsequently allowed her to increase that limit when she attempted to make a purchase. That purchase pushed Plaintiff's credit limit over the originally agreed upon credit limit. Incident to extending Plaintiff's credit limit, Defendants assessed her an over-limit charge of $29.00 a month for every month her balance remained over the original limit. Plaintiff alleges that this charge was omitted from the finance charge calculation on her monthly statement, and instead was posted to her account as a new purchase or debit on which additional finance charges were calculated.

As indicated, Plaintiff seeks to bring a class action on behalf of all customers who hold or have held credit cards issued by Defendants. She alleges that Defendants' practice of imposing over-limit fees in the manner described above is pervasive. Plaintiff claims that Defendants routinely permit their customers to exceed their originally agreed upon credit limits upon request, and then impose upon them an over-limit fee for going over that limit. Plaintiff further alleges that the foregoing results in an exorbitant penalty that often amounts to an annual percentage rate of nearly sixty percent on credit extended over the limit. As a result of Defendants' alleged TILA violations, Plaintiff requests equitable relief, including a declaratory judgment that the over-limit fee is not properly disclosed pursuant to TILA (count I), and monetary damages (count II).

As further explained below, the district court dismissed Plaintiff's complaint on Defendants' motion for failure to state a claim under Fed. R. Civ. P. 12(b)(6) because the administrative regulations interpreting TILA (hereinafter "Regulation Z") expressly exclude fees charged for exceeding a credit limit from the definition of the "finance charge."

## DISCUSSION

### I.

This Court reviews *de novo* a district court's dismissal of a complaint under Rule 12(b)(6). *Hammonds v. Norfolk S. Corp.*, 156 F.3d 701, 704 (6th Cir. 1998) (citing *Merriweather v. City of Memphis*, 107 F.3d 396,398 (6th Cir. 1997)). On such a motion, the Court accepts as true well-pleaded facts alleged in the complaint, and will dismiss the complaint only if it appears beyond doubt that the plaintiff can prove no set of facts in support of the claims that would entitle him or her to relief. *Bibbo v. Dean Witter Reynolds, Inc.*, 151 F.3d 559, 561 (6th Cir. 1998) (citing *Sistrunk v. City of Strongsville*, 99 F.3d 194, 197 (6th Cir. 1996)). All allegations must be construed in the light most favorable to the plaintiff. *Mertik v. Blalock*, 983 F.2d 1353, 1355 (6th Cir. 1993).

### II.

Plaintiff argues that the plain language of TILA mandates that Defendants include as a finance charge the monthly fee imposed on Plaintiff's monthly statement for exceeding her credit limit. She admits that Regulation Z, promulgated by the FRB, has excluded from the definition of the term "finance charge" fees imposed for exceeding a credit limit. However, she argues that the regulation conflicts with the plain language of the statute, and in such cases, the Supreme Court has held that courts must ignore the regulation so as to give effect to the statute. She further contends that TILA is a consumer protection statute and must be construed liberally so as to prevent the type of action in which Defendants are now engaged.

Defendants contend that the district court properly dismissed Plaintiff's complaint because Regulation Z excludes over-limit fees from the definition of finance charge. They argue that Regulation Z's exclusion of over-limit fees from the definition of the finance charge is



rationally based and not contrary to TILA, and that the Supreme Court and this Court have stressed that courts should defer to the FRB's interpretations of TILA. Finally, Defendants claim that they acted in good faith compliance with Regulation Z when they failed to disclose the over-limit fee as a finance charge, and that pursuant to 15 U.S.C. § 1640(f), they are therefore immune from civil liability in the instant action.

### III.

The purpose of TILA is "to assure a meaningful disclosure of credit terms so that the consumer will be able to compare . . . the various credit terms available to him and avoid the uninformed use of credit and to protect the consumer against inaccurate and unfair credit billing and credit card practices." 15 U.S.C. § 1601(a); *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 559 (1989) (explaining that TILA's purpose is to assure "meaningful disclosure of credit terms to consumers"); *Begala v. Ohio, Nat'l Ass'n*, 163 F.3d 948, 950 (6th Cir. 1999) (holding that TILA "was enacted to promote the informed use of credit by consumers by requiring meaningful disclosure of credit terms") (citation omitted). Because of TILA's purpose of protecting consumers in credit transactions, this Court has held that the statute must be construed liberally in the consumer's favor. *See Jones v. TransOhio Sav. Ass'n*, 747 F.2d 1037, 1040 (6th Cir. 1984) ("TILA is a remedial statute and should be construed liberally in favor of the consumer.") (citations omitted).

TILA, however, is not exhaustive. Congress delegated to the FRB the authority "to elaborate and expand the legal framework governing the commerce in credit." *Milhollin*, 444 U.S. at 567 ("Congress has specifically designated the Federal Reserve Board . . . as the primary source for interpretation and application of the truth-in-lending law."); *see also* 15 U.S.C. § 1604(a) (explaining that the FRB "shall prescribe regulations to carry out the purposes of this

subchapter"). The Supreme Court has recognized that TILA is a highly technical act and that deference should be given to the FRB's interpretation of the Act as long as such interpretations are not irrational. *Milhollin*, 444 U.S. at 568. In explaining the deference that courts should afford to the FRB's interpretation of TILA, the Court stated:

> wholly apart from jurisprudential considerations or congressional intent, deference to the . . . [FRB] is compelled by necessity; a court that tries to chart a true course to the Act's purpose embarks upon a voyage without compass when it disregards the agency's views. The concept of "meaningful disclosure" that animates TILA . . . cannot be applied in the abstract. *Meaningful* disclosure does not mean *more* disclosure. Rather, it describes a balance between "competing considerations of complete disclosure . . . and the need to avoid . . . [informational overload.]"

*Id.* (italics in the original). This Court also has stated that "in TILA actions, . . . it will defer to the regulations interpreting the Act." *Begala*, 163 F.3d at 950 (citing *Milhollin*, 444 U.S. at 565). However, while the FRB has been given broad authority in prescribing regulations to carry out the purposes of TILA, this authority is confined to efforts to "effectuate the purpose of [the Act], to prevent circumvention or evasion thereof, or to facilitate compliance therewith." 15 U.S.C. § 1604(a). Thus, the FRB's authority is not without limits. *See e.g.*, *Anderson Bros. Ford v. Valencia*, 452 U.S. 205, 219 (1981) (holding that courts need only defer to FRB regulations that are not repugnant to TILA); *Consumers Union of the U.S., Inc. v. Fed. Reserve Bd.*, 938 F.2d 266, 272-74 (D.C. Cir. 1991) (holding that despite authority § 1604(a) grants to the FRB, remand was necessary for clarification of the rationality of regulations that conflicted with TILA disclosure requirements regarding home equity loan promotional discount rates and repayment options).

Section 1605(a) defines "finance charge" as follows:



> Except as otherwise provided in this section, the amount of the finance charge in connection with any consumer credit transaction shall be determined as the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit.

15 U.S.C. § 1605(a). Similar to TILA, Regulation Z defines "finance charge" as "the cost of consumer credit," including "any charge payable directly or indirectly by the consumer" and imposed by the creditor as a result of the extension of credit. 12 C.F.R. § 226.4(a) (2001). Regulation Z excludes from this definition of finance charge "[c]harges for actual unanticipated late payment, for exceeding a credit limit, or for delinquency, default, or a similar occurrence." 12 C.F.R. § 226.4(c)(2).[1]

Relying on *Milhollin*, the district court found that it was bound to give deference to the FRB's interpretation of the term finance charge, and dismissed Plaintiff's complaint because of Regulation Z's exclusion of over-limit fees from the definition of finance charge. The district court noted that all the categories of fees excluded from the definition of finance charge under § 226.4(c)(2) arise when the terms under which the credit was extended have been breached by

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[1] Prior to 1981, Regulation Z did not exclude charges for exceeding a credit limit from the term "finance charge." The FRB amended the regulation after Congress passed the Truth In Lending Simplification Act, Pub. L. No. 96-221, 94 Stat. 168, 168-186 (1980). *See* 35 Mass. Prac. Consumer Rights and Remedies § 161 (West 2000); Final Rule, 46 Fed. Reg. 20848, 20855 (April 7, 1981) ("[P]aragraph (c)(2) [of the current regulation] corresponds to § 226.4(c) of the [former] regulation, but adds one item to the list. The revised regulation specifically excludes charges for exceeding a credit limit from the finance charge.").

the borrower. The district court determined that "Plaintiff seeks a liberal interpretation of TILA, notwithstanding the plain language of Regulation Z." It concluded that the FRB "rationally" excluded fees for exceeding a credit limit from the definition of "finance charge" because such fees are "charges for past credit extension events that were not agreed to by the parties." According to the district court, no agreement was reached by the parties regarding customers "unilaterally exceeding their credit limit." Thus, it held that the FRB rationally had determined that because fees such as the one Plaintiff was charged in this case were only assessed where the customer breached the original terms of the credit agreement, any fees imposed incident to that breach could not be construed as finance charges.

Defendants argue that the district court was correct and that this Court must uphold the FRB's interpretation of Regulation Z because it is "rationally based." Just as the district court found, Defendants contend that the over-limit fee and all other fees excluded from the statutory definition of "finance charge" under § 226.4(c)(2) share a "common theme." Relying on language from the district court's opinion, Defendants claim,

> All of these post-credit extension occurrences are done in violation of the agreed upon terms upon which the credit was extended. Such charges are never imposed upon a borrower who simply follows the terms of the agreement. The Federal Reserve Board rationally determined that these charges, for acts amounting to breaches of the agreed upon credit extension, are not finance charges.

Defendant's Br. at 14.

We disagree with Defendants and the district court for several reasons. First, as explained above, we have held that TILA, as a remedial statute, must be given a liberal interpretation in favor of consumers in order to protect them



in credit transactions. *See Begala*, 163 F.3d at 950; *Jones*, 747 F.2d at 1040. Thus, TILA must be interpreted liberally in Plaintiff's favor in the instant case. Further, despite the language in § 226.4(c)(2) of Regulation Z, we believe the fee imposed in this case falls squarely within the statutory definition of a finance charge.

It is rudimentary that "the starting point for interpreting a statute is the language of the statute itself." *Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980). "Absent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive." *Id.; see also Bradley v. Austin*, 841 F.2d 1288, 1293 (6th Cir. 1988) (explaining that "[i]n determining the meaning of legislation, we must first look to the plain language of the statute itself"). "The ordinary meaning of the words used are presumed to express congressional purposes . . . ." *First Nat'l Bank of Council Bluffs v. Office of the Comptroller of the Currency*, 956 F.2d 1456, 1462-63 (8th Cir. 1992) (citation omitted). As stated previously, TILA defines the finance charge as the sum of *"all charges"* paid by the person to whom credit is extended and assessed by the creditor "as an incident to the extension of credit." 15 U.S.C. § 1605(a) (emphasis added). Plaintiff alleges that Defendants imposed the $29.00 over-limit fee after she requested and was granted additional credit. Had Defendants not granted Plaintiff's request for additional credit, which resulted in her exceeding her credit limit, they would not have imposed the over-limit fee. Thus, under a plain reading of § 1605(a) and the general rules of statutory interpretation, the $29.00 fee was imposed incident to the extension of credit to Plaintiff, and pursuant to TILA, Defendants were obligated to disclose the fee as a finance charge on her monthly statement. *See* 15 U.S.C. § 1638(a)(3) (listing the finance charge as one of the required disclosures by a creditor); 12 C.F.R. § 226.7(f) (requiring amount of finance charge to be listed on periodic statement).

Defendants fail to argue that the $29.00 fee was not imposed incident to the extension of credit, but instead vehemently contend that this Court must defer to Regulation Z.[2] We disagree. "[W]e defer to an agency's reasonable

[2] Defendants and several amici filed petitions for rehearing and suggestion for rehearing *en banc* in this case. The amici, including various industry organizations, challenge our understanding of the actual operation of the credit card industry, and in doing so, raise numerous factual issues not in the record. For instance, they raise the issue of why and when credit card issuers impose over-limit fees in the manner in which they do. We reject these arguments for two reasons. First, the particular factual issues the amici raise regarding the actual workings of the industry were never raised below and are not in the record. As a general rule, "[w]hile an amicus may offer assistance in resolving issues properly before a court, it may not raise additional issues or arguments not raised by the parties." *Cellnet Communications v. FCC*, 149 F.3d 429, 443 (6th Cir. 1998) (citations omitted). Moreover, even had Defendants themselves raised these additional factual issues, we could not consider them on a petition for rehearing. *See White v. Anchor Motor Freight, Inc.*, 899 F.2d 555, 559 (6th Cir. 1990) (noting that this Court reviews "the case presented to the district court rather than a better case fashioned after the district court's order"); *see also Blakely v. United States*, 276 F.3d 853, 865 n.5 (6th Cir. 2002) (noting that Court would not consider evidence presented in support of the plaintiff's claim because the evidence had not been presented to the district court). Second, the arguments fail on the merits. The Federal Reserve Board (FRB) concedes in its amicus filing that there might be instances where a creditor imposes a low credit limit and routinely allows consumers to charge above that limit even after over-limit fees have been assessed. In such instances, the FRB acknowledges that the over-limit fee actually becomes an anticipated cost of the credit extension and is therefore a finance charge. In the instant case, Defendants fail to challenge Plaintiff's allegations that Defendants knowingly and routinely permit their credit-card customers to exceed their agreed upon credit limits, and then impose over-limit fees for doing so. In deciding a motion to dismiss, pursuant to

(continued. . . )



interpretation of a statute it administers unless the intent of Congress is clear." *Hamama v. I.N.S.*, 78 F.3d 233, 239 (6th Cir. 1996) (citation and internal quotation marks omitted). Where a statute and an agency regulation regarding the same matters conflict, courts must defer to the statute. *See e.g., K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 291 (1988) (explaining that to determine whether a regulation conflicts with a statute, the starting point is the statute itself; if the statute is clear and unambiguous the matter is over and the courts and agency must give effect to Congressional intent). "In ascertaining the plain meaning of the statute, the court must look to the particular statutory language at issue, as well as the language and design of the statute as a whole." *Id.; United States v. Butler*, 207 F.3d 839, 847 (6th Cir. 2000) (same). As we have explained, TILA is a remedial statute that must be construed broadly in the consumer's favor. *Begala*, 163 F.3d at 950. The over-limit fee Defendants impose falls squarely within the statutory definition of a finance charge. *See* 15 U.S.C. § 1605(a). There is no ambiguity. Further, as is evident from other provisions of the Act, "[t]he disclosure of the finance charge is at the heart of" TILA. Elizabeth Renuart & Kathleen E. Keest, National Consumer Law Center, *Truth in Lending* § 3.1.1, at 81(4th ed. 1999). The finance charge is intended to provide an accurate price tag for credit, and TILA

(. . . continued)

Rule 12(b)(6), we must accept these allegations as true and construe them in Plaintiff's favor. *Bibbo*, 151 F.3d at 561; *Mertik*, 983 F.2d at 1355. Because we are barred from a procedural standpoint from considering the new factual issues the amici seek to bring to our attention, we deny the petitions for rehearing. It should be emphasized that while this opinion holds that Plaintiff has stated a cause of action based on the allegations in her complaint, Defendants may seek to establish on remand that Plaintiff's allegations have no factual basis and that the fees at issue in this litigation do not violate TILA.

demands that it be disclosed more conspicuously than other items. *Id.* (footnote citations omitted); *see also* 15 U.S.C. § 1632(a) (listing finance charge as one of few items that must be "disclosed *more conspicuously* than other items, data, or information. . .") (emphasis added); 15 U.S.C. § 1638(a)(3) (including the finance charge as one of the required disclosures). "Seeing the cold, hard figures [i.e., the finance charge] helps consumers to determine whether to use credit or not," as high credit costs encourage restraint. Renuart & Keest, *supra*, § 3.1.1 at 81. To that end, the failure to accurately represent the finance charge contravenes TILA's statutory goal of providing adequate disclosure in order that the consumer will knowledgeably be able to compare credit options and "avoid the uninformed use of credit."[3] 15 U.S.C. § 1601(a); *Jones*, 747 F.2d at 1040. Thus, considering the language in § 1605(a) defining the finance charge and the language and purpose of TILA as a whole, Regulation Z's exclusion of over-limit fees, such as those imposed in this case, from the "finance charge" conflicts with the express language of TILA. In such instances, the regulation cannot stand. *Cartier*, 486 U.S. at 291.

We also disagree with the district court's finding that the $29.00 fee was imposed because Plaintiff "unilaterally exceeded her credit limit." Plaintiff alleges in her complaint that Defendants permitted her to exceed her original credit limit. She further contends in her brief that the additional

[3] In addition, Plaintiff not only alleges that Defendants permit their customers to exceed their credit limits by extending additional credit to them and imposing upon them a fee for doing so, but also that Defendants "systematically" post this fee on their customers' monthly billing statements as a new purchase, on which additional finance charges are calculated. (J.A. at 7, 13 ¶¶ 9, 37). Plaintiff essentially alleges that she is incurring a double penalty, as she is assessed an over-limit fee as a penalty, and then must pay finance charges on that fee. In light of our holding, we need not address this issue.



credit was extended to allow her to make new purchases. Accepting these facts as true, Plaintiff did not unilaterally exceed her credit limit. Rather, she requested additional credit in order to make purchases. Defendants could have declined her request. Instead, they granted it, and then charged her a $29.00 fee for doing so. Plaintiff would have breached the terms of her original credit agreement but for Defendants' willingness to renegotiate the agreement. Because Defendants knowingly allowed Plaintiff to exceed her credit limit and charged her a fee incident to this extension of credit, that fee is by definition a finance charge. *See* 15 U.S.C. § 1605(a).

Moreover, despite Defendants' arguments to the contrary, we see a vast distinction between the over-limit charge at issue in this case and the other charges listed in 12 C.F.R. § 226.4(c)(2). Defendants cite several cases in which courts have held that because fees imposed for unanticipated late payment, default, or delinquency are excluded from the definition of finance charges under § 226.4(c)(2), they are not finance charges within the meaning of TILA. *See e.g.*, *United States v. Citrin*, 972 F.2d 1044, 1051(9th Cir. 1992) (holding that government did not breach TILA because it failed to "clearly inform" a scholarship recipient of the damages due upon his default; under 12 C.F.R. § 226.4(c)(2) charges for default are not finance charges); *In re Rothenberg*, 203 B.R. 827, 836 (D.C. Bankr. 1996) (same). None of the cases cited by Defendants involve the type of over-limit fee at issue in this case.[4] Further, in situations

[4] Defendants also cite to unpublished decisions to support their argument. *See Sims v. Union Planters Bank of Northeast Miss., N.A*, No. 3:96CV206-B-A, 1997 WL 170309, at *2 (N.D. Miss. Feb. 27, 1997) (dismissing plaintiff's complaint and holding that $5 fee bank charged because plaintiff's account was overdrawn was not an undisclosed finance charge because it was not a finance charge under Regulation Z); *Strutman v. Chem. Bank*, No. 94 Civ. 5013,1996 WL 539845, at *3 (S.D.N.Y. Sept. 24, 1996) (holding

(continued. . . )

where the consumer is in default, is delinquent in payment, or submits an unanticipated late payment, the lender is placed in a position of having *unexpectedly* to bear the cost of the borrower's tardiness. We find persuasive Plaintiff's argument that in such instances, "the lender is arguably at risk for failing to meet its own obligations if its customers are not meeting theirs, [and] the lender [should certainly be allowed to] impose a late fee or default fee to account for this assumed risk." Plaintiff's Br. at 14. However, the scenario is entirely different where, as here, the borrower has reached her credit limit, requests more credit, and the lender agrees to that extension of extra credit, but assesses a fee as a result. In such an instance, the fee clearly is imposed incident to the extension of credit. *See* 15 U.S.C. § 1605(a).

TILA states that the amount of the finance charge equals the sum of all charges payable by one to whom credit is extended, incident to the extension of that credit. 15 U.S.C. § 1605(a). Defendants charged Plaintiff a $29.00 over-limit

(. . . continued)
that $275 fee imposed by bank to deliver security to plaintiffs' new lender was not a finance charge because the fee was not assessed as an incident to the extension of credit). Neither of these cases involve fees for exceeding a credit limit under § 226(c)(2). Further, *Strutman* is easily distinguishable because the court in that case expressly held, and the facts of that case show, that the fee imposed was not incident to the extension of credit. *Strutman*, 1996 WL 5329845, at *3. The same holds true for *Hahn v. Hank's Ambulance Serv. Inc.*, 787 F.2d 543 (11th Cir. 1986), also cited by Defendants, where the court found persuasive the reasoning that the services rendered by an ambulance company did not result in extending credit. *Id.* at 544. In the instant case, it is unquestionable that the fee was imposed because Plaintiff was extended additional credit which caused her to exceed her originally agreed upon credit limit. In any event, the unpublished opinions cited by Defendants do not serve as binding authority on this Court. *See e.g., United States v. Barnes*, 278 F.3d 644, 648 n.1 (6th Cir. 2002).



fee after they agreed to extend her additional credit, and pursuant to TILA, that fee must be disclosed as a finance charge. 15 U.S.C. §§ 1605(a), 1638(a)(3). Further, to the extent TILA and Regulation Z conflict in this regard, the unambiguous language of TILA controls.[5]

## IV.

Defendants argue that even if this Court "invalidate[s] the provision of Regulation Z at issue here," they are entitled to the good faith immunity defense of § 1640(f). In pertinent part, 15 U.S.C. § 1640(f) provides,

[5] The dissent contends that Part III of the majority opinion's rationale is problematic for two reasons: (1) Plaintiff failed to allege that Defendants had foreknowledge of her over-limit charges, and (2) credit card issuers, such as Defendants, may not in all cases decide whether over-limit charges "will be permitted to go through." The first assertion is incorrect and the second is irrelevant, in light of our holding. Plaintiff alleges that Defendants routinely permit consumers to exceed their credit limits and did so in this case as to "each and every putative class member." (J.A. at 7, ¶¶ 7-8.) She further alleges that Defendants permitted all purported class members to make the charges that allowed them to exceed their applicable credit limits. (J.A. at 13, ¶¶ 34-35.) Thus, construing the allegations in the complaint in the light most favorable to Plaintiff, she clearly alleges that Defendants had foreknowledge of her over-limit charges. In addition, these allegations support Plaintiff's argument that Defendants make the decision as to whether over-limit charges "will be permitted to go through." While the dissent claims credit card issuers "may not, in all cases" make such decisions, such a hypothetical scenario is not before us. Plaintiff has alleged in her complaint that Defendants routinely allow consumers to exceed their applicable credit limits. *Id.* Thus, she has alleged that the ultimate decision squarely rests in the hands of Defendants. Contrary to the dissent's contention, our holding is of course limited to those instances in which the creditor knowingly permits the credit card holder to exceed his or her credit limit and then imposes a fee incident to the extension of that credit.

> No provision of this section, . . . imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board . . . notwithstanding that after such act or omission has occurred, such rule, regulation, interpretation, or approval is amended, rescinded or determined by judicial or other authority to be invalid for any reason.

*Id.* "This defense is available to a creditor only if he acts 'in conformity' with certain official interpretations of the Truth in Lending Act." *Cox v. First Nat'l Bank of Cincinnati*, 751 F.2d 815, 82 (6th Cir. 1985). Defendants contend that Plaintiff fails to allege that they did not act in good faith conformance with Regulation Z. Thus, Defendants assert that they are entitled to immunity under 15 U.S.C. § 1640(f). Plaintiff claims that this Court cannot consider this matter because Defendants raised it for the first time in their reply brief before the district court, which did not consider this argument. Plaintiff also contends that this Court should not entertain this argument because it raises factual issues, the resolution of which is inappropriate on the current motion. Plaintiff further argues that in addition to monetary damages, she seeks equitable relief, which is unaffected by Defendants' good faith reliance defense. *See* 15 U.S.C. § 1640(f) (relieving creditor/lender acting in good faith from liability.)

Although the district court did not expressly state in its opinion why it failed to consider Defendants' good faith argument, we note that district courts adhere to the general "well-settled" rule that "a party may not raise an issue for the first time in a reply brief." *See e.g., Books A Million, Inc. v. H & N Enters., Inc.*, 140 F. Supp. 2d 846, 859 (S.D. Ohio 2001) (citing *Aetna Cas. and Sur. Co. v. Leahey Const. Co., Inc.*, 219 F.3d 519, 545 (6th Cir. 2000)). The courts of appeal typically refrain from considering issues not passed upon by the lower courts. *See Blue Cross & Blue Shield Mut. of Ohio*



*v. Blue Cross and Blue Shield Ass'n*, 110 F.3d 318, 335 (6th Cir. 1997). That rule, however, is not inflexible. As we have explained:

> [t]he matter of what questions may be taken up and resolved for the first time on appeal is one left primarily to the discretion of the courts of appeals, to be exercised on the facts of individual cases . . . Certainly there are circumstances in which a federal appellate court is justified in resolving an issue not passed on below, *as where the proper resolution is beyond any doubt*, . . . or where "injustice might otherwise result." Similarly, the Ninth Circuit has held. . . [that an appellate court has] discretion to decide whether to address an issue that the district court did not reach if the question is a purely legal one and the record has been fully developed prior to appeal; in deciding whether to exercise this discretion we should consider whether the resolution of the issue is clear and whether injustice might otherwise result.

*Id.* (citations omitted and emphasis added).

Because we believe that the issue regarding Defendants' good faith compliance with Regulation Z is clear in this case, we exercise our discretion to entertain their argument although it was not passed upon below.

On its face, Regulation Z expressly states that charges imposed for exceeding credit limits are excluded from the "finance charge." *See* 12 C.F.R. § 226.4(c)(2). Even assuming all allegations in Plaintiff's complaint are true and construing those allegations in the light most favorable to Plaintiff, it is undisputed that the fee at issue in this case was imposed for "exceeding a credit limit." Consequently, even if the statute required Defendants to disclose this fee as a finance charge, unequivocally Regulation Z did not. *See* 15 U.S.C. § 1640(f) (no liability for "any act done or omitted in good faith in conformity with" a FRB regulation); *Basham v.*

*Fin. Am. Corp.*, 583 F.2d 918, 922-23 (7th Cir. 1978) (affirming dismissal and/or grant of summary judgment in favor of defendants and explaining that because defendants undisputedly complied with Regulation Z, although the Regulation conflicted with disclosure requirements under TILA, they could not, pursuant to § 1640(f), be held civilly liable for their failure to follow TILA); *see also* 5 Charles Alan Wright & Arthur R. Miller, Federal Practice and Procedure, § 1277 at 468 (2d ed. 1990) (explaining that although general rule prevents asserting affirmative defense on a motion to dismiss, where defense is plain on its face, courts generally allow it) (footnote citations omitted). In addition, Plaintiff has not pointed to any disputed factual issue regarding whether Defendants acted in good faith by relying on the exclusionary provisions in Regulation Z. *Cf. Leon v. Washington Mut. Bank, N.A.*, 164 F. Supp. 2d 1034, 1039 (N.D. Ill. 2001) (noting that contrary to defendant's position that language contained in Rider created only an incidental interest obviating need for disclosure under TILA, two other federal courts previously had held that exact language created a security interest which did require disclosure). Based upon the undisputed facts of this case, 15 U.S.C. § 1640(f) applies, and Defendants are entitled to immunity from civil liability for failing to disclose as part of the finance charge on Plaintiffs monthly statements the fee imposed for exceeding her credit limit. We therefore affirm the dismissal of count II of Plaintiff's complaint to the extent she seeks monetary damages.[6]

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[6] Plaintiff is in no way prejudiced by our decision. Indeed, in her reply brief she states that Defendants' good faith defense should not bar her claims inasmuch as she not only seeks monetary but also equitable relief. During oral arguments, her counsel reasserted this position. However, by holding that on the facts of this case, it is beyond cavil that Defendants complied with Regulation Z and pursuant to 15 U.S.C. § 1640(f) should he afforded immunity from civil damages, we in no way imply that in

(continued. . . )



## CONCLUSION

The district court erred in failing to construe TILA liberally in Plaintiff's favor and in concluding that the fee assessed Plaintiff in this case resulted from a unilateral breach on Plaintiffs' part when she exceeded her credit limit. Construing the allegations in Plaintiff's complaint in her favor, the over-limit fee was imposed incident to the extension of credit that Defendants agreed to grant Plaintiff, and therefore falls squarely within the statutory definition of the "finance charge." Nevertheless, Defendants undisputedly relied on the plain language of Regulation Z, which, although it conflicts with the plain language of TILA, expressly excludes fees charged for exceeding a credit limit from the definition of the "finance charge." Thus, pursuant to TILA, Defendants may not be held liable for damages for such omission; however, Plaintiff may proceed with her claim against Defendants for equitable relief upon remand. For the forgoing reasons, we **AFFIRM in part, REVERSE in part,** and **REMAND** the matter to the district court.

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## DISSENTING IN PART, CONCURRING IN PART

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EDGAR, Chief District Judge, dissenting in part, concurring in part. Because I do not think that the language of the Truth in Lending Act ("TILA") necessarily warrants

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(. . . continued)

all cases where a party arguably or seemingly has complied with Regulation Z, he is entitled to the benefits of this statutory defense. *See e.g.*, *Cox*, 751 F.2d at 825 (explaining that § 1640(f) provides no protection to a creditor who honestly but mistakenly interprets Regulation Z). (citations omitted). We need not decide at this time whether other instances may arise where reliance on § 1640(f)'s good faith conformance defense would he unavailing.

the inclusion of an over-limit fee in the finance charge, I dissent from Part III of the majority opinion.

15 U.S.C. § 1605(a) generally defines a finance charge as follows:

> Except as otherwise provided in this section, the amount of the finance charge in connection with any consumer credit transaction shall be determined as the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit.

The statute then specifies some examples of types of charges that must be included as a part of the finance charge disclosed to consumers. Regulation Z, promulgated by the Federal Reserve Board to implement the TILA, fleshes out in considerable detail what is, and what is not, to be included within the finance charge. As the majority points out, Regulation Z clearly *excludes* from the definition of finance charge "[c]harges for actual unanticipated late payment, for *exceeding a credit limit,* or for delinquency, default, or a similar occurrence." 12 C.F.R. § 226.4(c)(2) (emphasis supplied).

The majority concludes, contrary to the Federal Reserve Board, that an over-limit fee "falls squarely within the statutory definition of a finance charge . . . . There is no ambiguity." I respectfully disagree. Over-limit fees are nowhere mentioned in § 1605(a). The majority nonetheless finds that, in accordance with the general statutory definition of finance charge, the defendant has charged a fee "incident to the extension of credit." The majority's rationale is that an over-limit fee is "imposed incident to the extension of credit" because after the plaintiff reached her credit limit, she in effect requested more credit by exceeding the limit; and by permitting her to exceed the limit and charging her a fee, the defendants imposed the fee "incident to the extension of



credit." In other words the defendants knew that the plaintiff was making charges over her limit, before allowing her to do so.

There are two problems with this rationale. First, the plaintiff does not allege in her complaint that defendants had foreknowledge of the plaintiffs over-limit charges. The majority's factual conclusion appears to be based on contentions in plaintiff's brief. Since this case was decided on a motion to dismiss under Fed. R. Civ. P. 12(b)(6), we are limited to reviewing the facts as they appear in the complaint. *Mars v. Buckeye Rural Elec. Co-op., Inc.*, 277 F.3d 873, 877 (6th Cir. 2002); *Rose v. Hartford Underwriters Inc. Co.*, 203 F.3d 417, 420 (6th Cir. 2000). Second, the plaintiff's assertion in her brief that a credit card issuer "gets to make the decision as to whether or not [an over-limit] charge will be permitted to go through" may not, in all cases, be accurate. From our personal experience we know that many merchants check credit cards on-line before accepting customer charges. However, this may not be true in all cases; and, of course, the TILA and Regulation Z apply to all consumer credit transactions, not just those of the plaintiff.

We are admonished by the Supreme Court that:

> When a court reviews an agency's construction of the statute which it administers, . . . [and where a] court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction of the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.

*Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984). The Supreme Court has

also specifically said that in interpreting the TILA, the Federal Reserve Board's opinions construing the Act should be dispositive unless "demonstrably irrational." *Ford Motor Credit Company v. Milhollin*, 444 U.S. 555, 565 (1980). This circuit has held that "in TILA actions, we defer to the regulations interpreting the Act." *Begala* v. *PNC Bank, Ohio, National Ass'n*, 163 F.3d 948, 950 (6th Cir. 1998).

The majority's interpretation of § 1605(a) might well be a reasonable one; but so is that of the Federal Reserve Board. Certainly it cannot be said that the Federal Reserve's exclusion of over-limit charges from the finance charge in Regulation Z is demonstrably irrational. The Federal Reserve merely filled in a blank left by Congress in the TILA, and analogized over-limit charges to unanticipated late payments and charges for delinquency or default. These other charges are clearly not a part of the finance charge because they are, as the district court concluded, post extension of credit occurrences. The same can be reasonably said about over-limit fees.

Since the district court granted judgment to Household and MBNA on a Rule l2(b)(6) motion to dismiss, those parties found it unnecessary to bring to the attention of the district court additional facts about the handling of credit cards. The existence of these facts was made evident by briefs filed by the Federal Reserve Board and other amici in support of a petition for rehearing, which the majority has denied. Since neither the district court nor this court has had the opportunity to consider important facts bearing on the ways in which credit is extended, it is all the more inappropriate for the majority in this particular case to reach its conclusion that Regulation Z is not a permissible interpretation of the TILA.

The majority's conclusion in this case effectively amends Regulation Z in this circuit. The national uniformity



established by the Federal Reserve Board for consumer credit is thereby breached.[1] I do not think that there is a sufficient basis for this result. Of course, because the defendants relied on Regulation Z in good faith, I concur in the majority's conclusion in Part IV of its opinion that the defendants are entitled to immunity from civil liability under 15 U.S.C. § 1640(f).

I would affirm the decision of the district court in its entirety.

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[1] In its footnote 5, the majority says that it's holding is "limited to those instances in which the creditor knowingly permits the credit card holder to exceed his or her credit limit." Presumably this means that credit card issuers must only disclose an over-limit fee when they have been made aware that an over-limit charge is pending approval, and they then permit the charge to go through. Thus some card issuers may be required to disclose under some circumstances, while others may not. This merely adds to lack of uniformity and confusion.

**IN THE UNITED STATES DISTRICT COURT**
**FOR THE SOUTHERN DISTRICT OF OHIO**
**EASTERN DIVISION**

**SHARON R. PFENNIG,**

**Plaintiff,**

**v.**

**Case No. 2:99-CV-815**
**JUDGE EDMUND A. SARGUS, JR.**
**Magistrate Judge Norah McCann King**

**HOUSEHOLD CREDIT SERVICES, INC., et al.,**

**Defendants.**

## OPINION AND ORDER

This matter is before the Court for consideration of the Defendants' Motion to Dismiss the complaint pursuant to Fed. R. Civ. P. 12(b)(6). (Doc. #11). For the reasons that follow, the Defendants' motion is granted.

### I.

Plaintiff Sharon R. Pfenning brings this action on her own behalf and on behalf of a putative class of credit card holders pursuant to the Truth in Lending Act ["TILA"], 15 U.S.C. § 1640(e), against Defendants Household Credit Services, Inc. ["Household"] and MBNA America Bank, N.A. ["MBNA"]. Plaintiff challenges the "over limit charge assessment" utilized by the Defendants. Plaintiff seeks declaratory, injunctive and monetary relief. The Court entertains this action pursuant to 28 U.S.C. §1331.

In her complaint, Plaintiff states that she is the holder of a credit card originally issued by Household and now held by MBNA. (*Complaint* at ¶5). Plaintiff avers that all putative class members who hold or have held a credit card since



1990 occupy the same status as Plaintiff. (*Id.*). Plaintiff claims that although holders of the Defendants' credit cards are subject to a credit limit on their accounts, the Defendants routinely permit consumers to exceed the applicable limit and thereupon assess an "over limit fee" of twenty nine dollars per month to the consumer. (*Id.* at ¶¶7-8). Plaintiff alleges that such fee is "systematically omitted from the finance charge calculation on the consumer's monthly billing statement" and is "systematically posted to the account as a new purchase or other debit on which additional financing charges are calculated." (*Id.* at ¶9). Plaintiff asserts that the foregoing constitutes an exorbitant penalty that often amounts to an annual percentage rate of near sixty per cent on credit extended over the credit limit. (*Id.* at ¶22).

Plaintiff seeks a declaration that the Defendants' "over limit fee" is not properly disclosed under the TILA and under Federal Reserve Board Regulation Z, 12 C.F.R. §226.4(w). The Plaintiff further asserts that she, as well as members of the putative class, have suffered actual damages as a result of the alleged nondisclosure of the over limit fee. The Defendants assert that Plaintiffs claim fails to state a basis for relief.

### II.

A motion to dismiss for failure to state a claim pursuant to Rule 12(b)(6) "should not be granted unless it appears beyond a doubt that the plaintiff can prove no set of facts in support of his claim that would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957). All well-pleaded allegations must be taken as true and be construed most favorably toward the non-movant. *Schueer v. Rhodes*, 416 U.S. 232, 236 (1974); *Mayer v. Mylod*, 988 F.2d 635, 637 (6th Cir. 1993). While a court may not grant a Rule 12(b)(6) motion based on disbelief of a complaint's factual allegations, *Lawler v. Marshall*, 898 F.2d 1196, 1199 (6th Cir. 1990), the Court "need not accept as true legal conclusions or unwarranted factual inferences." *Morgan v.*

*Church's Fried Chicken*, 829 F.2d 10, 12 (6th Cir. 1987). Consequently, a complaint will not be dismissed pursuant to Rule 12(b)(6) unless there is no law to support the claims made, the facts alleged are insufficient to state a claim, or there is an insurmountable bar on the face of the complaint.

**III.**

The Defendants assert that Plaintiff's claim must fail because it is contrary to the plain language of the TILA as well as Regulation Z. The stated purpose of the TILA is as follows:

> [T]o assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and to avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair billing and credit practices.

15 U.S.C. § 1601(a). The statute requires lenders to make a clear and accurate disclosure of all finance charges imposed upon consumers in a credit transaction. 15 U.S.C. § 1638(a)(3). The term "finance charge" is defined in the following manner:

> [The] sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit.

15 U.S.C. §1605(a).

Plaintiff contends that the "over limit fee" assessed by the Defendants is imposed directly or indirectly by the creditor as an incident to the extension of credit and, thus, constitutes a finance charge which must be disclosed to the consumer. In opposition to this theory, the Defendants point out that Regulation Z specifically excludes charges for exceeding a credit limit from the definition of finance charge. Regulation Z provides, in relevant part:



> §266.4 Finance charge.
>
> (a) Definition. The finance charge is the cost of consumer credit as a dollar amount. It includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit. . . .
>
> * * *
>
> (c) Charges excluded from the finance charge. The following charges are not finance charges:
>
> * * *
>
> (2) Charges for actual unanticipated late payment, for exceeding a credit limit, or for delinquency, default, or similar occurrence.

12 C.F.R. §226.4(a), (c)(2).

The Defendants cite to a number of cases in which courts have held that a charge that is expressly excluded from the category of finance charges by Regulation Z, need not be disclosed to the consumer. *See e.g.*, *United States v. Citrin*, 972 F.2d 1044 (9th Cir. 1992) (holding that a default charge is not a finance charge for purposes of the TILA). Nonetheless, Plaintiff maintains that the "over limit fee" fits the definition of "finance charge" under the TILA and, furthermore, that to exclude the fee from the definition runs contrary to the legislative intent of the statute. Plaintiff seeks a liberal interpretation of the TILA, notwithstanding the plain language of Regulation Z.

This Court concludes that, in light of the plain language of Regulation Z, the "over limit fee" at issue in this case is not a finance charge subject to consumer disclosure under the TILA. While the Court is cognizant of the legislative intent of the TILA, the Court concludes that it is constrained to follow the interpretation of the statute as set forth in Regulation Z. Indeed, as the United States Supreme Court has observed, "considerable respect is due 'the interpretation

given [a] statute by the officers or agency charged with its administration.'" *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 566 (1980), quoting *Zenith Radio Corp. v. United States*, 437 U.S. 443, 450 (1978). Thus, this Court finds that it must give deference to the Federal Reserve Board's statutory interpretation of the term finance charge. In the Court's view, when a consumer exceeds the applicable credit limit, the extension of credit thereafter is distinct from the initial agreed upon extension of credit. Therefore, the Court finds that Regulation Z's exclusion of the "over limit fee" from the definition of "finance charge" is rationally based.

Regulation Z at Section 226.4(c)(2) excludes several categories of charges, all of which arise when the terms under which the credit was extended have been breached by the borrower. These categories include the making of unanticipated late payments or the exceeding of a credit limit. Further included in these categories are charges arising after a delinquency or default. Each of the categories include charges for past credit extension events that were not agreed to by the parties. The lender agreed to loan and the borrower agreed to borrow under agreed upon terms which were "incident to the extension of credit," as that term is used in 15 U.S.C. § 1605(a). No such agreement was reached permitting unanticipated late payments, delinquency, or default. No such agreement was reached as to the borrower unilaterally exceeding the agreed upon credit limit. All of these post-credit extension occurrences are done in violation of the agreed upon terms upon which the credit was extended. Such charges are never imposed upon a borrower who simply follows the terms of the agreement. The Federal Reserve Board rationally determined that these charges, for acts amounting to breaches of the agreed upon credit extension, are not finance charges.

In sum, Plaintiffs complaint fails to state a claim upon which relief can be granted.



**IV.**

Defendants' Motion to Dismiss **(Doc. #11)** is **GRANTED**. This action is hereby **DISMISSED** . The Clerk is **DIRECTED** to enter Judgment accordingly.

**IT IS SO ORDERED.**

8-31-2000
DATE

EDMUND A. SARGUS, JR.
UNITED STATES DISTRICT JUDGE

00-4213

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

SHARON R. PFENNIG,

*Plaintiff-Appellant,*

*v.*

HOUSEHOLD CREDIT SERVICES, INC., ET AL.,

*Defendants-Appellees.*

ORDER

**BEFORE**: CLAY and GILMAN, Circuit Judges; and EDGAR,* District Judge.

The court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active** judges of this court, and no judge of this court having requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

**ENTERED BY ORDER OF THE COURT**

[9-3-2002] **Leonard Green, Clerk**

* Hon. R. Allan Edgar, Chief United States District Judge for the Eastern District of Tennessee, sitting by designation.

** Judge Moore recused herself from participation in this ruling.



**UNITED STATES DISTRICT COURT**
**FOR THE SOUTHERN DISTRICT OF OHIO**
**EASTERN DIVISION**

SHARON R. PFENNIG,
2317 Waterpointe Court
Columbus, Ohio 43209

Individually and on behalf of all similarly-situated individuals

Plaintiffs,

v.

HOUSEHOLD CREDIT SERVICES INC.
c/o Corporate Trust Company
1209 Orange Street
Corporate Trust Center
Wilmington, Delaware 19801

And

MBNA AMERICA BANK, N.A.
1100 North King Street
Wilmington, Delaware 19884

Defendants.

Case No. C2-99 815

**CLASS ACTION COMPLAINT**

With Jury Demand
Endorsed Hereon

Now comes the named plaintiff, Sharon R. Pfennig, by and through counsel, and for her class action complaint against the defendants, Household Credit Services, Inc. and MBNA America Bank, N.A., states as follows:

**PARTIES**

1. The named plaintiff, Sharon R. Pfennig, is an adult individual presently residing in Columbus, Ohio. As a credit

card holder of the defendant banks, Ms. Pfennig is a "consumer" as defined by 15 U.S.C. § 1602 (h).

2. The defendant, Household Credit Services, Inc. ("Household"), is a Delaware corporation with its principal place of business in Prospect Heights, Illinois. Household is a "creditor" as defined by 15 U.S.C. § 1602 (f).

3. The defendant, MBNA America Bank, N.A. ("MBNA"), is a Delaware Corporation doing business in the State of Ohio and elsewhere throughout the United States of America. MBNA is a "creditor" as defined by 15 U.S.C. § 1602 (f).

## JURISDICTION AND VENUE

4. This Court has subject matter jurisdiction over this Complaint pursuant to the Truth in Lending Act, 15 U.S.C. § 1640(e). Venue in this judicial district is proper as the events complained of by the named plaintiff took place in this district.

## FACTUAL ALLEGATIONS

5. The named plaintiff is the holder of a credit card formerly issued or held by the defendant, Household, and now held by the defendant, MBNA. All putative class members herein as defined below hold or held a credit card issued and/or presently held by Household and/or MBNA.

6. Upon information and belief, the defendants have a uniform policy of assigning a credit limit to all credit cards issued to consumers in their normal course of business. This "credit limit" is systematically represented by and through the defendants' standardized monthly billing statement as the maximum amount of credit available to the consumer on said credit card.

7. The defendants routinely permit consumers to exceed the applicable credit limit on credit card accounts. The defendants allowed the named plaintiff and each and every



putative class member herein to exceed the "credit limit" posted for each credit card account.

8. Once the consumer is permitted to exceed his or her applicable credit limit, the defendants systematically charge the consumer an "over limit charge assessment" or "over limit fee." This fee is only imposed when additional credit is extended to the consumer over and above his or her alleged "credit limit." The fee—a fee totaling as much as twenty-nine dollars ($29.00) per month—is charged each and every month during which the consumer's balance exceeds the alleged "credit limit."

9. The "over limit charge assessment" or "over limit fee" for the additional extension of credit is systematically omitted from the finance charge calculation on the consumer's monthly billing statement. In fact, the fee is systematically posted to the account as a new purchase or other debit on which additional financing charges are calculated.

## EQUITABLE TOLLING

10. Any applicable statutes of limitations have been tolled by the defendants' affirmative and intentional acts of fraudulent concealment, suppression and denial of evidence relating to the fraudulent conduct alleged herein. The named plaintiff could not reasonably have discovered the facts regarding the defendants' misconduct because of the defendants' deliberate efforts to render the named plaintiff ignorant of the fraud. In fact, upon information and belief, of the putative class remain ignorant of the fraud.

## CLASS ACTION ALLEGATIONS

11. The representative plaintiff, Sharon R. Pfennig, brings this action individually and on behalf of all persons similarly situated, as members of a proposed plaintiff Class ("the Class"), defined as follows:

All consumers who were charged or assessed a fee by Household Credit Services Inc. or MBNA America Bank N.A. for exceeding the applicable credit limit on a credit card held by Household Credit Services Inc. or MBNA America Bank N.A. at any time from 1990 through the present.

The named plaintiff is a member of this putative Class. Specifically excluded from this Class are: (1) the defendants, any entity in which either defendant has a controlling interest, and the officers, directors, affiliates, legal representatives, heirs, successors, subsidiaries, and/or assigns of any such individual or entity; and (2) any judge or judicial officer with responsibility over the management or resolution of this litigation, and members of the judicial officer's immediate family.

12. The members of the Class for whose benefit this action is brought are so numerous that joinder of all Class members is not practicable. The exact number of the Class is unknown to the representative plaintiff. However, in light of the hundreds of thousands of credit cards issued by the defendants on an annual basis, the number of putative class members is reasonably believed to be in excess of 10,000 persons.

13. The claims of the representative plaintiff are typical of, if not identical to, all members of the Class and the named plaintiff has no interest of which she is aware that is adverse or antagonistic to the interests of the Class. If the conduct of the defendants violates federal truth in lending laws as it applies to the named plaintiff, then said uniform conduct violates federal truth in lending laws with respect to the entire putative class.

14. The representative plaintiff will fairly and adequately protect the interests of the Class. The named plaintiff is committed to putting an end to the defendants' wrongful conduct. She is committed to the vigorous prosecution of this



action and, to that end, has retained competent counsel experienced in complex litigation of this nature.

15. The plaintiff Class is proper for certification under Rule 23(b)(2) of the Federal Rules of Civil Procedure. The defendants' actions complained of herein are generally applicable to all Class members, thereby making final injunctive relief appropriate with respect to the Class as a whole.

16. The plaintiff Class is proper for certification under Rule 23(b)(3) of the Federal Rules of Civil Procedure. The claims of the putative Class, in this regard, grow out of the same actions and policies, and rest on the same grounds, applying more or less equally to all of the members of the Class.

17. A class action is superior to other available methods for the fair and efficient adjudication of the claims asserted herein. Because damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it impracticable for the Class to seek redress individually for the wrongs they have suffered. Members of the Class do not have a particular interest in individually controlling the prosecution of separate actions. The representative plaintiff envisions no difficulty in the management of this case as a class action. Absent a class action, the defendants will likely continue their unlawful conduct, as well as retain the millions of dollars improperly obtained from Class members through the defendants' wrongdoing.

18. There are questions of law and fact which are common to the members of the Class and which predominate over questions affecting only individual members. Common questions of law and fact include, but are not limited to, the following:

(a) Whether the defendants have a standardized procedure to charge an "over limit charge assessment" or "over limit fee" as a condition of the extension of

additional credit over and above the customer's applicable credit limit;

(b) Whether the defendants automatically include and require an "over limit charge assessment" or "over limit fee" incident to the extension of additional credit over and above the customer's applicable credit limit;

(c) Whether the defendants systematically fail to disclose this "over limit charge assessment" or "over limit fee" as part of the finance charge as required by TILA; and

(d) Whether the defendants' calculated and uniform conduct is in violation of federal truth in lending laws.

19. Notice can be provided to members of the Class by regular United States Mail since all members of the Class are known to the defendants who, either independently or through their agents, maintain a mailing list of all Class members. In addition, notice can be provided to members of the Class by publication via television, radio and/or print as necessary.

**COUNT I**
**DECLARATORY RELIEF**

20. The representative plaintiff hereby incorporates by reference all well-pleaded allegations contained in the preceding paragraphs as if fully rewritten herein.

21. The defendants knowingly allow, authorize and participate in granting customers additional credit over and above their alleged credit limits. Nonetheless, the defendants attempt to penalize these customers for the defendants' own consent to grant these customers this additional credit by charging a monthly "over limit charge assessment" or "over limit fee" that is not accurately disclosed to the customer as a cost of said credit.

22. The subject "over limit charge assessment" or "over limit fee" of twenty-nine dollars ($29.00) per month



constitutes an exorbitant penalty in that it often equates to an annual percentage rate upwards of sixty percent (60%) on the credit extended to the customer over and above the alleged credit limit. This charge is assessed in addition to the disclosed finance charge the customer is required to pay and is included in the amount on which said finance charge is calculated.

23. There exists an actual and justiciable controversy between the putative Class and the defendants as to the validity of the "over limit charge assessment" or "over limit fee" charged to the named plaintiff's account and the accounts of each putative Class member herein.

24. Substantial property rights depend upon the validity or lack thereof of this monthly assessment and the manner in which it is disclosed.

25. The named plaintiff, individually and on behalf of the putative Class, seeks a declaratory judgment against the defendants that the "over limit charge assessment" or "over limit fee" is not properly disclosed pursuant to the Truth in Lending Act, 15 U.S.C. § 1601 *et seq.*

**COUNT TWO**
**VIOLATION OF TRUTH IN LENDING ACT**

26. The representative plaintiff hereby incorporates by reference all well-pleaded allegations contained in the preceding paragraphs as if fully rewritten herein.

27. The Court has jurisdiction over the claims of the named plaintiff and the entire putative Class pursuant to 15 U.S.C. § 1640(e).

28. The Truth in Lending Act ("TILA"), 15 U.S.C. § 1601 *et seq.*, is a consumer protective statute designed to insure the accurate and meaningful disclosure of the true cost of credit to the consumer. *See*, 15 U.S.C. § 1601.

29. The defendants are creditors within the meaning of TILA, 15 U.S.C. § 1601 *et seq.*, and implementing the

Federal Reserve Board Regulation Z, 12 C.F.R. part 226 ("Regulation Z"), in that they enter into more than twenty-five (25) transactions per annum where credit is extended to a consumer that is repayable in more than four (4) installments.

30. The transaction of the named plaintiff and each and every putative Class member is a consumer credit transaction within the meaning of TILA and Regulation Z.

31. A "finance charge" is defined by 15 U.S.C. § 1605 (a) as follows:

> [T]he amount of the finance charge in connection with any consumer credit transaction shall be determined as the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit.
>
> * * *
>
> Examples of charges which are included in the finance charge include any of the following types of charges which are applicable:
>
> (1)Interest, time price differential, and any amount payable under a point, discount, or other system of additional charges.
>
> (2)Service or carrying charge. ***

*See*, 15 U.S.C. § 1605 (a).

32. The only items properly excluded from computation of the finance charge include fees and charges to be paid to public officials, non-filing fees and taxes, none of which are applicable here. *See*, 15 U.S.C. § 1605 (d).

33. Regulation Z defines the finance charge as follows:

> [T]he amount of the finance charge in connection with any transaction shall be determined as a sum of all



> charges, payable directly or indirectly by the customer, and imposed, directly or indirectly, by the creditor as an incident to or as a condition of the extension of credit[.]

*See*, 12 C.F.R. § 226.4 (w).

34. The defendants allowed the named plaintiff to make charges and/or assessed the named plaintiff charges that allowed her balance to exceed her credit limit of two thousand dollars ($2000.00). Similarly, the defendants allowed each and every putative class member to exceed his or her applicable credit limit.

35. By allowing the named plaintiff and each and every putative class member to exceed their applicable credit limit, the defendants made an additional extension of credit to said consumers over and above the alleged "credit limit." As a condition of this additional extension of credit, the defendants systematically impose an "over limit charge assessment" or "over limit fee" for each month the customer's balance exceeds the original credit limit. This assessment or fee is incident to or a condition of the additional extension of credit over and above the customer's alleged credit limit.

36. The defendants routinely exclude this additional assessment or fee from the amount disclosed to the customer as part of the finance charge on the standardized monthly billing statement. Instead, the defendants represent to the customer that the annual percentage rate is the percentage rate originally disclosed to the customer when, in fact, said rate is significantly greater in light of the substantial additional charge assessed via the "over limit charge assessment" or "over limit fee."

37. The defendants systematically post the "over limit charge assessment" or "over limit fee" as a new purchase or other debit on the consumer's monthly billing statement. As such, this additional fee is included in the amount on which

the monthly finance charge is calculated. Thus, the customer is being charged twice for the additional extension of credit.

38. By failing to disclose the "over limit charge assessment" or "over limit fee" as part of the finance charge and by including said fee in the amount on which the monthly finance charge is calculated, the defendants grossly misstate and/or misrepresent the true cost of credit to the consumer.

39. The defendants have misstated and/or misrepresented the true cost of credit to the named plaintiff and all other Class members by systematically failing to disclose an accurate finance charge in violation of the purpose and express disclosure requirements of TILA.

40. The named plaintiff and all other Class members herein have suffered actual damages as a result of the defendants' violation of TILA. The defendants are liable to these plaintiffs for actual damages in an amount to be proved at trial, plus attorneys' fees and costs herein, pursuant to 15 U.S.C. § 1640 (a).

**WHEREFORE**, the named plaintiff, Sharon R. Pfennig, prays for judgment in her favor and in favor of the Class and against the defendants, Household Credit Services, Inc. and MBNA America Bank, N.A., and for the following relief:

(a) an order certifying the putative Class pursuant to Federal Rule of Civil Procedure 23(b)(2) and, additionally or in the alternative, an order certifying the Class pursuant to Federal Rule of Civil Procedure 23(b)(3);

(b) a declaration that TILA requires the "over limit charge assessment" or "over limit fee" imposed by the defendants upon customers who are permitted to exceed their applicable credit limit be disclosed as part of the finance charge;

(c) a declaration that the defendants' systematic and standard policy of misrepresenting the finance charge



associated with a credit card issued by the defendants violates TILA;

(d) an injunction permanently prohibiting the defendants from engaging in the conduct described herein;

(e) an award of statutory damages as provided for in 15 U.S.C. § 1640(a)(2);

(f) an award of actual damages in excess of Twenty-Five Thousand and no/100 Dollars ($25,000.00);

(g) an award of attorney's and expert's fees, costs and disbursements to the fullest extent permitted under 15 U.S.C. § 1640 (a)(3) and federal law; and

(h) such other and further relief as the Court may deem just and proper.

Respectfully submitted,

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Attorneys for Plaintiff

**JURY DEMAND**

PLAINTIFF DEMANDS A TRIAL TO A JURY ON ALL ISSUES SO TRIABLE.

DATED this 24th day of August, 1999.

Joseph F. Murray, Esq.



IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 00-4213

SHARON R. PFENNIG,

Plaintiff-Appellant,

v.

HOUSEHOLD CREDIT SERVICES, INC. and
MBNA AMERICA BANK, N.A.,
Defendants-Appellees.

# BRIEF FOR BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM AS *AMICUS CURIAE* IN SUPPORT OF DEFENDANTS-APPELLEES' PETITION FOR REHEARING AND SUGGESTION FOR REHEARING EN BANC

This is a case of exceptional importance in that the panel decision nullifies an agency rule that implements a complex statute affecting creditors and consumers nationwide. The case is likely to affect the credit card industry in circumstances that are much broader than the facts cited by the panel majority. As a result of the decision, differing and conflicting standards will apply in an area in which uniform disclosure of credit costs is of utmost importance in effectuating the purposes of the statute in question. Pursuant to Federal Rule of Appellate Procedure 29, the Board of Governors of the Federal Reserve System (the "Board") respectfully submits this brief *amicus curiae* in support of rehearing of the panel decision.

## STATEMENT

On April 11, 2002, a divided panel of this Court issued its Opinion in this case. The opinion invalidated a provision of the Board's Regulation Z, 12 C.F.R. Part 226, implementing the Truth in Lending Act ("TILA"). TILA promotes informed use of consumer credit by providing uniform disclosures to consumers about the costs and terms of consumer credit. Specifically, Regulation Z requires credit card issuers to disclose the cost of credit as a dollar amount, known as the "finance charge," and as an annual percentage rate. Since 1981, Regulation Z has specifically excluded from the definition of "finance charge" any fees imposed on a consumer for exceeding the credit limit established by the issuer. 12 C.F.R. § 226.4(c)(2).

Based on the facts alleged in the plaintiff's complaint, the panel majority held that "Regulation Z's exclusion of over-limit fees, such as those imposed in this case, from the 'finance charge' conflicts with the express language of TILA" and thus that "the regulation cannot stand." Slip Op. at 11. The majority found that an over-limit fee is a fee "incident to the extension of credit" for purposes of the TILA definition of "finance charge." The dissenting judge disagreed that the language of TILA expressly requires inclusion of over-limit fees as part of the finance charge, and would have deferred to the Board's interpretation of the statute, as expressed in Regulation Z, in accordance with Supreme Court precedent holding that such interpretations are dispositive unless "demonstrably irrational." Slip Op. at 20, citing *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 565 (1980); *see also*, *Anderson Brothers Ford v. Valencia*, 452 U.S. 205, 219 (1981) ("absent some obvious repugnance to the statute, the Board's regulation implementing [TILA] should be accepted by the courts."). The Board was not a party to the case below, and was unaware until it learned of the April 11 decision that the validity of this portion of Regulation Z was at issue.



## ARGUMENT

The Board believes that this matter presents an exceptionally strong case for rehearing or rehearing *en banc*. The panel decision erred as a matter of law in a number of respects.

1. *First*, the decision was based, in part, on a determination that the language of TILA "unambiguously" requires inclusion of over-limit fees in the finance charge. This is error. TILA defines a "finance charge" to include all charges imposed on the consumer by the creditor "as an incident to the extension of credit." 15 U.S.C. § 1605(a). However, TILA expressly contemplates that in addition to "finance charges," an open-end credit plan may impose "other charges" that must be disclosed separately. *See* 15 U.S.C. § 1637(a)(5). Thus, not every fee associated with the credit plan is considered a charge "incident to the extension of credit." Moreover, nothing in TILA explicitly requires the finance charge to include fees, such as over-limit fees, imposed when a consumer violates the credit agreement with the issuer. The same section of Regulation Z that excludes over-limit fees from the finance charge also excludes other fees for violations of the account agreement, such as late fees and default fees. These fees could also be viewed as being imposed incident to the extension of credit, because, absent the extension of credit, none of them would be incurred. However, despite the seemingly all-inclusive definition of "finance charge" in TILA, even the panel majority accepted the view that these fees were properly excluded from the finance charge disclosure. Slip Op. at 12. The Board's decision to exclude from the finance charge fees generally associated with acts of default under the credit contract, including over-limit fees, does not conflict with the plain language of the TILA definition of "finance charge."

2. *Second*, because the statutory language defining "finance charge" is ambiguous as applied to particular types of credit-related fees, the panel decision erred by substituting

its interpretation of TILA for that of the agency authorized to interpret the statute. The Board's rule excluding over-limit fees from the finance charge is based on the rational assumption that the fees are imposed when the consumer uses the credit plan in a manner that violates the terms of the plan. Based on the rule, consumers can use uniform disclosures to compare the cost of credit card programs offered by different creditors that do not account for contingent costs that may be imposed under each plan for unanticipated events such as late payments or over-limit situations.[1]

Because the statute does not explicitly deal with the treatment of over-limit fees, the panel should have deferred to the Board's rule, which rationally excludes the fees from the finance charge. In unusually expansive language, TILA grants to the Board authority to "prescribe regulations to carry out the purposes of this title [which] may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary to effectuate the purposes of this title, to prevent circumvention or evasion thereof, or to facilitate compliance therewith." 15 U.S.C. § 1604(a). The Supreme Court has recognized that "because of their complexity and variety, . . . credit transactions defy exhaustive regulation by a single statute. Congress therefore delegated expansive authority to the Federal Reserve Board to elaborate and expand the legal framework governing commerce in credit." *Milhollin, supra*, 444 U.S. at 560. For that reason, *"deference is especially aSppropriate in the process of interpreting the Truth in Lending Act and Regulation Z. Unless demonstrably*

[1] Regulation Z requires fees that are charged for exceeding a credit limit to be disclosed at account-opening and on periodic statements as "other charges" imposed under the credit plan. 12 C.F.R. §§ 226.6(b), 226.7(h).



*irrational, Federal Reserve Board staff opinions construing the Act or Regulation should be dispositive." Id.* at 565.[2]

Instead of following this Supreme Court directive and reviewing the regulatory provision under the deferential standard applied in such cases, the panel undertook its own review of the statute and identified its own rule of decision: that "TILA must be interpreted liberally in Plaintiff's favor in the instant case." Slip Op. at 9. On that basis, it determined that the statutory language should be *read* to include over-limit fees as included in the finance charge. This analysis usurped the deference that should have been given to the Board in interpreting the complex statutory provisions in the light of industry practices and the purposes of the statute.[3]

3. *Third*, in reaching its own interpretation of the statute, the panel majority erred in finding that the over-limit fee allegedly imposed in this case and that is referred to in Regulation Z was necessarily imposed "as an incident to the extension of credit" within the TILA definition of "finance charge." In particular, the panel majority erred in assuming

[2] In addition, TILA expressly gives immunity to creditors that rely in "good faith" on interpretations of TILA by the Board even if the interpretations are later held to be invalid by a court. 15 U.S.C. § 1640(f). The Supreme Court has indicated that this "statutory provision signals an unmistakable congressional decision to treat administrative rulemaking and interpretation under TILA as authoritative." *Milhollin, supra*, 444 U.S. at 568-69.

[3] *Milhollin* held that courts should defer to unofficial Board *staff opinions* interpreting the statute and the Board's Regulation Z unless those interpretations are "demonstrably irrational." Quite obviously, the degree of deference due to the regulation itself, which was promulgated by the Board pursuant to the notice and comment provisions of the Administrative Procedure Act, 5 U.S.C. § 551 *et seq.*, is at least as great.

that merely because the creditor allegedly authorized a proposed credit transaction that ultimately contributed to the account balance exceeding the cardholder's pre-approved credit limit, the creditor in effect had "renegotiated the [credit card] agreement" and "knowingly" agreed to extend additional credit to the cardholder in excess of the prior limit in return for the fee. Slip Op. at 11 and 14 n.4.[4]

This erroneous conclusion causes the panel's decision to cover a standard industry practice that protects consumers and creditors against fraud and loss but that does not involve any intention by the parties to "renegotiate" the credit limit originally set by the creditor on the basis of its determination of the consumer's risk profile.[5] Many card issuers participate in a system that allows the merchant to obtain an authorization for specific credit card transactions. This process allows the merchant to check whether the card is stolen, the account has been terminated, or transactions in the account have been blocked due, for example, to fraudulent

[4] The complaint does not even allege that the credit limit was the product of any negotiation with the issuer. Indeed, the factual allegations in the complaint conform to industry practice in which the credit limit is established unilaterally by the issuer. *See* Complaint § 6 ("defendants have a uniform policy of assigning a credit limit to all credit cards issued to consumers in their normal course of business.").

[5] The case was decided on a motion to dismiss, so all of plaintiffs allegations were assumed to be true. None of those allegations, however, suggested that the issuer actually agreed to an increase in the credit limit when it authorized a particular transaction. Indeed, the complaint alleged that fees are charged "each and every month during which the consumer's balance exceeds the alleged 'credit limit.'" Complaint ¶ 8. If anything, this suggests that from the creditor's viewpoint the credit limit continued to be the amount originally set by the creditor.



use of the card. The review is handled electronically and virtually instantaneously.

One part, but only one part, of this review involves a check on the amount of outstanding charges on the account and the overall credit limit on the account, and a comparison of those figures to the amount identified by the merchant as relating to the transaction at issue. This part of the database check may suggest that the transaction would cause the consumer's balance to exceed his or her pre-set credit limit. Importantly, however, it cannot be determined with complete accuracy at this point whether the account balance actually exceeds the credit limit, for a number of reasons. First, credits to the consumer's account are not posted until the end of the day. Thus, for example, a transaction that appears to push the account balance over the credit limit at 4:00 p.m. may turn out to have no such effect when a payment reducing the account balance is posted later that day.[6] Second, in many cases, instead of seeking authorization for the actual transaction amount, a merchant will send in a request for a nominal amount simply in order to determine whether the consumer has a "live" card.[7] In such a case, the actual transaction may cause the account balance to exceed the credit limit even though the authorization request gave the issuer no notice of that possibility. Third, in some cases, such as hotel or car rental charges, merchants can "block" large amounts of credit on check-in to ensure that the charge will be authorized when the consumer checks out and pays,

[6] In fact, the situation is even more complex because payments must be posted to an account "as of" the day they are received, even if it takes a few days for the creditor to process the payment. Regulation Z, 12 C.F.R. § 226.10(a).

[7] The issuer generally bears the credit risk as a practical matter, so the merchant may be less concerned with whether the consumer will pay the credit card bill than with whether the issuer will pay the merchant.

making an account look substantially closer to its credit limit than it in fact is.

Because the database check includes inaccuracies such as these, creditors generally do not deny authorization on the mere suspicion that a transaction would cause the account balance to exceed the consumer's credit limit. Nor is it feasible to impose the over-limit fee at the time of the particular transaction that may have that effect. Rather, card issuers typically determine whether to impose the fee only at the end of the billing cycle, when it can be determined that all charges and credits to the account establish that the consumer is in fact over the credit limit, and when other factors, such as the consumer's payment history, the amount by which the limit is exceeded, and whether the limit has been exceeded in the past, for example, may be taken into account. Only then—when the issuer is in a position to know whether the cardholder's credit behavior gives rise to the credit risk concerns that the over-limit fee is designed to address—will the issuer typically impose the charge.

Thus, over-limit fees are generally imposed only when consumers actually exceed the pre-established credit limit for some period of time, in order to impose discipline on consumer credit usage and to compensate the creditor for the added credit risk involved. The fact that a creditor authorizes a transaction that may ultimately cause the account balance to exceed the credit limit does not evidence a "willingness to renegotiate the agreement," as the panel erroneously assumed (Slip Op. at 11), and does not result in a revised credit limit going forward.[8] Nor is the over-limit fee rightly

[8] To be sure, there may be circumstances in which a course of dealing between card issuer and consumer could lead to the conclusion that a charge denominated as an over-limit fee is in fact an expected charge for extending credit itself. For example, a creditor that issues a card with an extraordinarily low credit limit and routinely allows the consumer to keep on charging above that

(continued. . . )



seen as imposed in connection with a specific extension of credit. Rather, because it is generally applied well after-the-fact on the basis of a backward look at the account some time after the particular over-limit transaction was made, and because it is imposed to affect consumer behavior to comply with the requirements of the credit agreement, the over-limit fee is more akin to other charges—such as late fees—that are not finance charges because they are not incident to a particular extension of credit. *See* 12 C.F.R. § 226.4(c)(2).

4. *Fourth*, the Board believes that the issue raised by the panel majority is one of exceptional importance given the practical implications of the panel's ruling. Regulation Z is a highly complex and technical regulation that applies to credit card issuers operating nationwide card programs. For this reason, uniform rules are of paramount importance. *See Milhollin*, *supra*, 444 U.S. at 568 (legislative history of TILA reflects "a decided preference for resolving interpretive issues by uniform administrative decision, rather than piecemeal through litigation."). The panel decision, if permitted to stand, would create serious difficulties for national credit card companies that would comply with the language of Regulation Z outside of the Sixth Circuit and must comply with the separate rule adopted by the panel within the Sixth Circuit.[9] Even within the Sixth Circuit alone,

(. . . continued)
limit even after over-limit fees have been assessed repeatedly may be using the fee as a substitute for finance charges. No such course of dealing was alleged in this case. Even if it were, it would provide no basis to invalidate the Board's rule, but would simply allow the consumer to argue that the charge imposed was not legitimately an over-limit charge exempt from the finance charge under § 226.4(c)(2), but was actually simply an anticipated cost of the credit extension and therefore a finance charge under § 226.4(a).

[9] A creditor attempting to comply with the panel's view of TILA's requirements nationwide would run the risk that a court

(continued. . . )

compliance could cause substantial confusion on the part of consumers, because under the rule enunciated by the panel, some over-limit fees would be included in, and disclosed as, finance charges while others would not.[10]

The only way to reconcile the conflicting requirements of the Sixth Circuit rule and the rule that exists elsewhere in the country would be to stop charging over-limit fees altogether, or to refuse to authorize any transaction that might be determined later to exceed the credit limit. The first option would eliminate for creditors an important tool for ensuring consumer discipline in the use of credit and mitigating credit risk, while the second would not only unnecessarily inconvenience large numbers of consumers, but would undoubtedly lead to contract or other claims for unwarranted denials of credit.

## CONCLUSION

For all of these reasons, the Board believes that the panel decision should be reconsidered by the full Court sitting *en*

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(. . . continued)
outside this jurisdiction would require it to comply with Regulation Z as written. A creditor that complies with the Sixth Circuit's decision outside the Sixth Circuit would not be entitled to the "good faith defense" authorized by TILA, because that defense only applies to compliance with the Board's regulations. TILA, 15 U.S.C. § 1640(a). *Hamilton v. Southern Discount Co.*, 656 F.2d 150, 152 (5th Cir. 1981).

[10] Moreover, a creditor could not simply decide to treat *all* over-limit fees as finance charges, because Regulation Z, with which the creditor is legally obligated to comply, provides that the finance charge does not include such fees, and the only exception to this requirement is the panel's rule relating to situations where the creditor "knowingly permits the cardholder to exceed his or her credit limit [by authorizing the transaction] and then imposes a fee." Slip Op. at 14 n.4.



*banc*, and that the judgment of the district court should be affirmed.

Respectfully submitted,.

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No. 02-857

IN THE

# Supreme Court of the United States

HOUSEHOLD CREDIT SERVICES, INC.
and MBNA AMERICA BANK, N.A.,

*Petitioners,*

*v.*

SHARON R. PFENNIG,

*Respondent.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

## BRIEF IN OPPOSITION

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## REASONS FOR DENYING THE PETITION

The sole question presented by the Petition is whether a reviewing court is bound to defer to a regulation of the Federal Reserve Board interpreting the Truth in Lending Act ("TILA"), 15 U.S.C. §§ 1601, *et seq.*, when that regulation conflicts with an unambiguous provision of the statute.

Petitioners argue that the Sixth Circuit improperly substituted its interpretation of TILA's definition of a finance charge for that of the Federal Reserve Board. *See* Pet. at *i*. According to Petitioners, the Sixth Circuit misapplied this Court's holding in *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555 (1980), when it determined that an over-limit fee admittedly imposed incident to an additional extension of credit beyond the customer's original credit limit is a finance charge within the plain language of Section 1605(a) of the Act and must be disclosed as such. *See* Pet. at 10.

The Sixth Circuit's ruling creates no split in circuits on this issue and, in fact, tracks numerous decisions of this Court mandating that the unambiguous language of a statute controls over any conflicting regulation. Accordingly, there exists no justification for this Court to grant review.

### I.

### THERE IS NO CIRCUIT SPLIT

No other court of appeals has entertained the same question raised in the Petition. The Sixth Circuit is the first to address whether a fee imposed incident to granting a consumer an additional extension of credit to exceed his or her original credit limit constitutes a finance charge as that term is plainly defined in TILA.

Petitioners do not dispute that no other court of appeals has broached the same question at issue here. Instead, Petitioners suggest that the decision below generally conflicts with decisions of other courts of appeals on the question of deference. *See* Pet. at 10. According to Petitioners, "other courts of appeals, unlike the Sixth Circuit, have accorded a high degree of deference to the Federal Reserve's interpretations of TILA." *See* Pet. at 13. This argument simply is not supported by the language of the lower court decision.

In its decision, the Sixth Circuit specifically acknowledged and affirmed the same general, well-established principle referenced in each of the cases cited by Petitioners, *i.e.*, that the Federal Reserve Board is to be given considerable deference with respect to its interpretation of TILA. *See* Pet., App. at A5-A6 (citing *Milhollin*, *supra*, 444 U.S. at 568; *Begala v. Ohio, Nat'l Ass'n*, 163 F.3d 948, 950 (6th Cir. 1999)). Nothing in the decision below challenges or runs afoul of this principle.

Furthermore, none of the cases cited by Petitioners involves a statutory provision determined to be clear and unambiguous by the court of appeals, as is the case with the decision at issue here. As will be discussed at length below, this fact is dispositive. *See, e.g.*, *Chemical Manufacturers Ass'n v. NRDC*, 470 U.S. 116, 125 (1985) (citing *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843, n.9 (1984); *SEC v. Sloan*, 436 U.S. 103, 117-118 (1978)) ("if Congress has clearly expressed an intent contrary to that of the Agency, our duty is to enforce the will of Congress.").

Petitioners have failed to identify any split in the circuits on the question presented here. As such, accepting review of this case is unwarranted.



## II.

## THE COURT OF APPEALS DID NOT MISAPPLY THIS COURT'S HOLDING IN *MILHOLLIN*

The crux of the Petition is that the court of appeals allegedly misapplied this Court's holding in *Milhollin*. Even if that were accurate, it would provide no basis for review. "A petition for a writ of certiorari is rarely granted when the asserted error consists of erroneous factual findings or the misapplication of a properly stated rule of law." Rule 10.

Moreover, the decision below makes clear that the court of appeals was very mindful of the deference due the Federal Reserve's interpretation of TILA. The Sixth Circuit undertook a careful analysis of the *Milhollin* decision in deciding the case below. *See* Pet., App. at A5-A6. However, citing this Court's decision in *Anderson Bros. Ford v. Valencia*, 452 U.S. 205, 219 (1981), the court of appeals acknowledged that "the FRB's authority is not without limits." *See* Pet., App. at A6. Indeed, this Court has held on numerous occasions that a reviewing court must not give credence to a regulation that contravenes the plain language or clear intent of a federal statute:

> If the statute is clear and unambiguous "that is the end of the matter, for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." . . . The traditional deference courts pay to agency interpretation is not to be applied to alter the clearly expressed intent of Congress.

*Kmart Corp. v. Cartier, Inc.*, 486 U.S. 281, 291 (1988) (quoting *Chevron*, *supra*, 467 U.S. at 842-843 (1984)).

*See also Chemical Manufacturers Ass'n*, *supra*, 470 U.S. at 125 ("Of course, if Congress has clearly expressed an intent contrary to that of the Agency, our duty is to enforce the will of Congress."); *Board of Governors, FRS v. Dimension Financial*, 474 U.S. 361, 368 (1986) ("no amount of agency expertise – however sound may be the result – " can change the plain meaning of the statute itself).

Therefore, the Sixth Circuit began its decision where this Court directed it should, *i.e.*, with the plain language of TILA. *See* Pet., App. at A9 (citing *Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980) ("It is rudimentary that 'the starting point for interpreting a statute is the language of the statute itself.'"). *See also Good Samaritan Hosp. v. Shalala*, 508 U.S. 402, 409 (1993) ("The starting point in interpreting a statute is its language[.]"). "In ascertaining the plain meaning of the statute, the court must look to the particular statutory language at issue, as well as the language and design of the statute as a whole." *Chevron*, *supra*, 467 U.S. at 291 (citing *Bethesda Hospital Ass'n v. Bowen*, 485 U.S. 399, 403-405 (1988); *Offshore Logistics, Inc. v. Tallentire*, 477 U.S. 207, 220-221 (1986)). In doing so, "it is appropriate to assume that the ordinary meaning of the language that Congress employed accurately expresses the legislative purpose." *Mills Music, Inc. v. Snyder*, 469 U.S. 153, 164 (1985).

With this precedent in mind, the court of appeals held that there is no ambiguity in the particular statutory language at issue. *See* Pet., App. at A11. Specifically, TILA states that all charges "incident to the extension of credit" must be disclosed as part of the finance charge. *See* 15 U.S.C. § 1605(a). The common meaning of the phrase "incident to the extension of credit" is echoed by the Federal Reserve



Board's definition, which uses virtually identical language: "any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor *as an incident to or a condition of the extension of credit* (emphasis added)." *See* 12 C.F.R. § 226.4(a).

Applying the plain language of the statute, the Sixth Circuit concluded that no regulatory interpretation of the phrase "incident to the extension of credit" was necessary: "the borrower has reached her credit limit, requests more credit, and the lender agreed to that extension of extra credit, but assesses a fee as a result. In such instance, the fee clearly is imposed incident to the extension of credit." *See* Pet., App. at A14 (citing 15 U.S.C. § 1605(a)). In coming to this conclusion, the Sixth Circuit was influenced by the fact that Petitioners never disputed the key fact. *Id.* at A10 ("Defendants fail to argue that the $29.00 fee was not imposed incident to the extension of credit"). Rather, they seek a rule of law that regardless of the plain language of the statute, a reviewing court must always defer to the regulation. Following the holding in *Kmart Corp.*, 486 U.S. at 291, the Sixth Circuit refused to impose such a standard. *Id.* at A10-A11.

Based on the plain language of the statute and Petitioners' failure to dispute its unambiguous application to the facts, the court of appeals determined that "the fee imposed in this case falls squarely within the statutory definition of a finance charge[.]" *See* Pet., App. at A9. This determination stays true to the substantial Supreme Court precedent on point. As such, there exists no justification for this Court to review the decision.

## III.

## REGULATION OF THE CREDIT CARD INDUSTRY IS NOT THREATENED BY THE DECISION BELOW

According to Petitioners, allowing the lower court decision to stand would create "regulatory and compliance problems for the Federal Reserve and the credit card industry because it creates conflicting disclosure obligations." Pet. at 17. This contention is overblown and fails for a number of reasons.

First, although suggesting that the decision will create one rule in the Sixth Circuit and another in the rest of the country, Petitioners fail to identify how requiring credit card issuers to comply with the plain language of TILA creates differing obligations from circuit to circuit. If a credit card issuer is conditioning an additional extension of credit on the imposition of a fee, that fee necessarily is "incident to the extension of credit" as that phrase is used in Section 1605(a). *See* Pet., App. At A9. Thus, regardless of the circuit in which the credit card issuer is doing business, TILA requires it to disclose that fee as part of the finance charge.

Similarly, the suggestion that some over-limit fees would have to be disclosed while others would not fails because disclosure of any particular fee as part of the finance charge rests on the application of the plain language of the statute, not the label arbitrarily assigned by the credit card issuer.

According to the Federal Reserve Board, the rule "excluding over-limit fees from the finance charge is based on the rational assumption that the fees are imposed when the consumer uses the credit plan in a manner that violates



the terms of the plan." *See* Pet., App. at A46. However, as the Sixth Circuit recognized, this case does not involve that situation:

> Plaintiff did not unilaterally exceed her credit limit. Rather, she requested additional credit in order to make purchases. Defendants could have declined her request. Instead, they granted it and then charged her a $29.00 fee for doing so. * * * Because Defendants knowingly allowed Plaintiff to exceed her credit limit and charged her a fee incident to this extension of credit, that fee is by definition a finance charge.

*See* Pet., App. at A13.

In this case, Petitioners are attempting to avoid disclosure of a true finance charge by calling it an "over-limit fee," so as to hide behind the protection of the Federal Reserve Board's regulation. Even the Federal Reserve Board concedes that when "a charge denominated as an over-limit fee is in fact an expected charge for extending credit itself[,]" that charge is actually "an anticipated cost of the credit extension and therefore a finance charge under § 226.4(a)." *See* Pet., App. at A50-A51 n.8.

Regardless of the label used to describe a specific fee, TILA undisputedly requires that if a charge is imposed "incident to the extension of credit," it must be disclosed as part of the finance charge. Nothing in the decision below changes that requirement.

## CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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No. 02-857

IN THE

# Supreme Court of the United States

OCTOBER TERM, 2002

HOUSEHOLD CREDIT SERVICES, INC.
and MBNA AMERICA BANK, N.A.,

*Petitioners,*

—v.—

SHARON R. PFENNIG,

*Respondent.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

## PETITIONERS' REPLY BRIEF

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February 12, 2003

## List of Parties and Rule 29.6 Statement

There have been no changes in the information previously submitted by petitioners pursuant to Rule 29.6 in their petition for a writ of certiorari.

IN THE

# Supreme Court of the United States

OCTOBER TERM, 2002

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HOUSEHOLD CREDIT SERVICES, INC. and
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SHARON R. PFENNIG,

*Respondent*.

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## PETITIONERS' REPLY BRIEF

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Respondent does not dispute that the Sixth Circuit invalidated a provision of Regulation Z, the regulations issued by the Federal Reserve to implement TILA. That the court held a federal regulation—unchallenged for over two decades—invalid is itself grounds for certiorari, quite apart from the severe practical consequences of the decision for the banking industry. At a minimum, the Court should call for the views of the Solicitor General to permit a further presentation of the Federal Reserve's views on the issue. (*See also* Pet. App. at A43-53.)

1. The question presented is undeniably important. Contrary to respondent's assertion (Opp'n at 3), the petition does not ask the Court simply to correct an erroneous legal ruling of concern only to the parties. The American Bankers Association, Consumer Bankers Association, American Financial Services Association, MasterCard International Incorporated and Visa U.S.A. Inc.—entities that speak for the entire banking industry—have submitted a brief in support of the petition emphasizing that the question presented "is of substantial importance to the banking industry as a whole

and will have severe consequences if not reversed." (Industry *Amici* Br. at 3.) As those *amici* explain (*id.* at 2-3, 12-16), the decision below, if allowed to stand, will create enormous compliance problems for and impose substantial financial costs on the banking industry, a view also expressed by the Federal Reserve in its *amicus* brief in the Sixth Circuit. (Pet. App. at A43, A51-52.)

Respondent's effort to minimize the practical implications of the decision does not withstand scrutiny. Both Chief Judge Edgar in his dissent and the Federal Reserve in its *amicus* brief observed that the decision below establishes a new and different disclosure rule in the Sixth Circuit, whereas Regulation Z continues to apply in other circuits. (Pet. App. at A22-23, A51-52.) Respondent dismisses this concern, stating that "Petitioners fail to identify how requiring credit card issuers to comply with the plain language of TILA creates differing obligations from circuit to circuit." (Opp'n at 6.) As the Federal Reserve stated, however, the Sixth Circuit's decision does not relieve credit card issuers of their obligation to comply with Regulation Z in other circuits. (Pet. App. at A51.) Because the obligations imposed by the Sixth Circuit's decision and Regulation Z are diametric opposites, creditors cannot implement a single nationwide disclosure that complies with both.

2. The Sixth Circuit's decision creates a conflict in the law governing creditors' disclosure obligations nationwide. In opposing certiorari, respondent relies principally on the absence of a strict circuit split on the precise question presented. (Opp'n at 1-2.) Although no other court of appeals has addressed the validity of Regulation Z's exclusion of over-limit fees from the finance charge, review by this Court is still necessary to bring about uniformity in the law among the circuits. As noted above, absent a decision by this Court, credit card issuers will have to comply with Regulation Z outside the Sixth Circuit and with a separate and conflicting rule within the Sixth Circuit. As a result, "regardless of



whether there is a split in judicial decisions concerning the validity of [12 C.F.R.] § 226.4(c)(2), nationwide creditors are subjected to conflicting legal obligations." (Industry *Amici* Br. at 13.)

3. The Sixth Circuit failed to accord the proper deference to the Federal Reserve's reasonable interpretation of TILA. The statute does not unambiguously provide that over-limit fees are part of the finance charge. It is silent on that precise question. Accordingly, the Federal Reserve issued a regulation that implements TILA's general language and provides specific guidance to creditors. That regulation excludes charges such as over-limit fees, late fees and other default fees from the finance charge on the ground that they are imposed not as "an incident to the extension of credit," but rather as an incident to a consumer's violation of the credit agreement. (Pet. App. at A45-51.) The Federal Reserve's interpretation of TILA reflected in that regulation is not "demonstrably irrational." *Ford Motor Co.* v. *Milhollin*, 444 U.S. 555, 565 (1980). Even the Sixth Circuit agreed that the Federal Reserve properly excluded late fees and other default fees from the finance charge because such fees are imposed as a result of the consumer's violation of the credit agreement. (Pet. App. at A13-14.)

Respondent argues that the Sixth Circuit "acknowledged" that the Federal Reserve's interpretation of TILA is entitled to deference. (Opp'n at 2.) Although it recited the proper standard, the Sixth Circuit did not faithfully apply it, rejecting the Federal Reserve's interpretation of the statute and substituting instead what the court believed to be "a liberal interpretation in favor of consumers." (Pet. App. at A8.) Rather than interpret TILA's general language itself—liberally or otherwise—the Sixth Circuit was required under *Milhollin* to defer to the Federal Reserve's rational interpretation of the statute.

4. The Sixth Circuit also exceeded its judicial role in attempting to determine on its own which rule would best

"protect [consumers] in credit transactions." (Pet. App. at A8-9.) Based on its broad experience and expert judgment, the Federal Reserve concluded that consumers are better able to compare the costs of credit if over-limit fees are separately disclosed as "other charges" and not included in the finance charge. That determination is based on a reasonable interpretation of TILA, and it is well within the Federal Reserve's broad authority to make such "classifications" as in its judgment are necessary to effectuate the purposes of the statute. 15 U.S.C. § 1604(a). As this Court observed in *Milhollin*, "a court that tries to chart a true course to the Act's purpose embarks upon a voyage without a compass when it disregards the agency's views." 444 U.S. at 568.

5. In arguing that the fee in this case was imposed "incident to the extension of credit," respondent contends that petitioners authorized her to incur the charge that put her over her credit limit. (Opp'n at 5, 7.) That contention is found nowhere in respondent's complaint, and thus cannot properly be considered on a motion to dismiss. (*See* Pet. App. at A21.) More fundamentally, the merchant authorization system on which respondent relies is *not* a means by which creditors authorize cardholders at the time of a transaction to exceed their credit limits. (*See id.* at A48-51; Industry *Amici* Br. at 6-10.) It is thus not at all accurate to say, as the Sixth Circuit did, that petitioners "renegotiate[d] the agreement" with respondent. (Pet. App. at A13.) There was no communication between petitioners and respondent concerning the credit limit applicable to respondent's account.

Contrary to respondent's suggestion (Opp'n at 5), petitioners have never conceded that the fee in this case was imposed "incident to the extension of credit." Instead, petitioners have always argued, as they do here, that the statute does not address the precise question at issue and that therefore *Milhollin* requires courts to defer to the Federal Reserve's rational interpretation of the statute. *See* Brief of



Defendants-Appellees at 11, 14, *Pfennig* v. *Household Credit Servs., Inc.*, 295 F.3d 522 (6th Cir. 2002) (No. 00-4213).

6. The fee at issue in this case was a legitimate over-limit fee. Respondent accuses petitioners of "attempting to avoid disclosure of a true finance charge by calling it an 'over-limit fee,' so as to hide behind the protection of the Federal Reserve Board's regulation." (Opp'n at 7.) This contention cannot even be reconciled with the Sixth Circuit's decision. The Sixth Circuit stated that "it is undisputed that the fee at issue in this case was imposed for 'exceeding a credit limit.'" (Pet. App. at A17.) The court thus held that petitioners are entitled to immunity from damages under 15 U.S.C. § 1640(f) because they complied in good faith with Regulation Z. (*Id.* at A18 n.6.) In short, respondent's suggestion (Opp'n at 6) that "over-limit fee" was simply a "label" that petitioners "arbitrarily assigned" to the fee in this case is false.

* * *

The petition should be granted. At a minimum, the Court should call for the views of the Solicitor General.

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HOUSEHOLD CREDIT SERVICES, INC. AND
MBNA AMERICA BANK, N.A.,
*Petitioners*,

v.

SHARON R. PFENNIG,
*Respondent.*

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit**

## BRIEF FOR AMICI CURIAE AMERICAN BANKERS ASSOCIATION, CONSUMER BANKERS ASSOCIATION, AMERICAN FINANCIAL SERVICES ASSOCIATION, MASTERCARD INTERNATIONAL INCORPORATED, AND VISA U.S.A. INC. IN SUPPORT OF PETITIONER

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## QUESTION PRESENTED

Whether the Sixth Circuit improperly substituted its interpretation of the Truth in Lending Act for that of the Federal Reserve—the agency authorized by Congress to interpret the statute—in invalidating an important provision of Regulation Z that affects tens of millions of consumer credit card agreements.

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## BRIEF FOR AMICI CURIAE AMERICAN BANKERS ASSOCIATION, CONSUMER BANKERS ASSOCIATION, AMERICAN FINANCIAL SERVICES ASSOCIATION, MASTERCARD INTERNATIONAL INCORPORATED, AND VISA U.S.A. INC. IN SUPPORT OF PETITIONER

## INTEREST OF AMICI[1]

This brief is filed by the American Bankers Association ("ABA"), Consumer Bankers Association ("CBA"),

[1] Pursuant to Rule 37.6, *amici* state that no counsel for a party authored this brief in whole or in part, and that no person or entity other than *amici*, or their members or counsel, made any monetary contribution to the preparation or submission of this brief. The written consent of all parties to the filing of this brief has been filed with the Clerk of this Court.

American Financial Services Association ("AFSA"), MasterCard International Incorporated ("MasterCard"), and Visa U.S.A. Inc. ("Visa"). The ABA is the principal national trade association of the banking industry in the United States, representing approximately 90 percent of the domestic assets of United States banks. Many ABA members issue credit cards. The CBA represents most of the nation's largest bank holding companies, institutions holding two-thirds of the industry's total assets. CBA member institutions are leaders in consumer finance, including credit cards. AFSA is a nationwide trade association that represents approximately 360 companies operating more than 10,000 offices engaged in the extension of consumer credit throughout the United States. MasterCard is a membership organization comprised of financial institutions that issue credit cards. Visa is part of a worldwide association of over 21,000 financial institutions that individually offer Visa-brand payment services, including Visa brand credit cards.

The decision below invalidated a regulation of the Federal Reserve Board, 12 C.F.R. § 226.4(c)(2), that excludes over-limit fees from the "finance charge" that a credit card issuer must disclose under the Truth in Lending Act. Members of the *amici* have relied on the Board's regulation for over two decades in disclosing the costs of consumer credit to their customers, and the decision, if it stands, will have enormous adverse financial, operational, and customer-impact consequences for these *amici* members. *Amici* and their members have long and substantial experience in dealing with the regulation at issue, and bring to this Court important perspectives on the legal rationale and justification for the regulation at issue, its impact, and its implementation.

## STATEMENT

In this case, the United States Court of Appeals for the Sixth Circuit held invalid a Federal Reserve Board ("Board") regulation that had been in effect for over two decades and



governed billions of creditor disclosures during that time. The Truth in Lending Act grants the Board expansive authority to promulgate implementing regulations. Pursuant to that authority, the Board in 1981 adopted a regulation providing that when creditors impose a fee on consumers for exceeding their credit limit, creditors should not disclose that fee as part of the "finance charge." Rather, creditors must disclose the over-limit fee separately as an "other charge." Until the present lawsuit, the validity of the Board's regulation had never been questioned. Nevertheless, in this class action dispute initiated by a consumer against two creditors, the Sixth Circuit ignored the expertise of the Board and held the regulation invalid. As the petition demonstrates well, the decision of the Sixth Circuit is incorrect for a number of reasons. *Amici* submit this brief in support of the petition because the issue presented is of substantial importance to the banking industry as a whole and will have severe consequences if not reversed.

1. Congress enacted the Truth in Lending Act ("TILA"), 15 U.S.C. § 1601 *et seq.*, in 1968 "to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available . . . and to protect the consumer against inaccurate and unfair credit billing and credit card practices." 15 U.S.C. § 1601(a). TILA is a disclosure statute; it does not "regulat[e] . . . the terms and conditions under which credit may be extended." H.R. Rep. No. 90-1040 (1967), *reprinted in* 1968 U.S.C.C.A.N. 1962, 1963. Congress determined that "full disclosure would aid the consumer in deciding for himself the reasonableness of the credit charges imposed," and thereby "encourage a wiser and more judicious use of consumer credit." *Id.*

Congress also recognized that, "[b]ecause of their complexity and variety, . . . credit transactions defy exhaustive regulations by a single statute." *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 559 (1980). "To accomplish its desired objective, Congress determined to lay

the structure of the Act broadly and to entrust its construction to an agency with the necessary experience and resources to monitor its operation." *Mourning* v. *Family Publ'ns Serv., Inc.*, 411 U.S. 356, 365 (1973). TILA therefore directs the Board to "prescribe regulations to carry out the [statute's] purposes," and provides broadly that the "regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes [of the statute], to prevent circumvention or evasion thereof, or to facilitate compliance therewith." 15 U.S.C. § 1604(a). Pursuant to this authority, the Board has issued a regulation, commonly known as Regulation Z, implementing TILA. *See* 12 C.F.R. Part 226.

Since its enactment, TILA has been amended several times. The most substantial amendments were accomplished in 1980 through the Truth in Lending Simplification and Reform Act ("Simplification Act"). *See* Pub. L. No. 96-221, Tit. VI, 94 Stat. 132, 180. Although the original TILA succeeded in many respects, Congress found that lengthy and intricate disclosures required by the statute often confused consumers. In addition, creditors "encountered increasing difficulty in keeping current with a steady stream of administrative interpretations and amendments, as well as highly technical judicial decisions." S. Rep. No. 96-73, at 2 (1979), *reprinted in* 1980 U.S.C.C.A.N. 280, 281. Despite sincere attempts to comply with TILA, creditors "found themselves in violation and subject to litigation" because of the statute's "increasing complexity and frequent changes." *Id.* Congress therefore amended TILA to, *inter alia*, "provide the consumer with clearer credit information [and] make creditor compliance easier." *Id.*; *see also* S. Rep. No. 96-368, at 16 (1979), *reprinted in* 1980 U.S.C.C.A.N. 236, 251. Following passage of the Simplification Act, the Board adopted a comprehensive revision of Regulation Z. *See* 46 Fed. Reg. 20,848 (Apr. 7, 1981). That revision included the



regulation at issue in the present case excluding over-limit fees from the "finance charge." *See* 12 C.F.R. § 226.4(c)(2).

As relevant to the present case, the current TILA regime operates in the following manner. Banks and other creditors that issue credit cards and charge cards ("issuing banks") must make disclosures to consumers on three principal occasions—in certain applications and solicitations, 15 U.S.C. § 1637(c); in initial disclosures prior to the opening of a credit plan, *id.* § 1637(a); and in periodic billing statements, *id.* § 1637(b). With regard to specified applications and solicitations, issuing banks must disclose, *inter alia*, the "annual percentage rate applicable to extensions of credit under such credit plan" and other applicable fees including "[o]ver-the-limit fee[s]." *Id.* § 1637(c)(1); *see also* 12 C.F.R. § 226.5a(b). With regard to initial disclosures, issuing banks must disclose, *inter alia*, the "conditions under which a finance charge may be imposed," the "method of determining the amount of the finance charge," the "periodic rates [that] may be used to compute the finance charge," and "other charges which may be imposed as part of the plan, and their method of computation." 15 U.S.C. § 1637(a); *see also* 12 C.F.R. § 226.6. Finally, with regard to periodic billing statements, issuing banks must disclose, *inter alia*, the "amount of any finance charge added to the account during the period," the "periodic rates [that] may be used to compute the finance charge," and "any charges other than finance charges debited to the account during the billing cycle." 15 U.S.C. § 1637(b)(4) and (5); 12 C.F.R. § 226.7(h).

The term "finance charge" thus has particular significance under TILA. Creditors must disclose significant charges imposed as a part of a credit plan either as a "finance charge" or as an "other charge." TILA provides that "the amount of the finance charge in connection with any consumer credit transaction shall be determined as the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of

credit." 15 U.S.C. § 1605(a). As part of its Regulation Z, the Board has promulgated a rule implementing this provision that lists for creditors certain definitive examples of charges that should, and should not, be included within the "finance charge." *See* 12 C.F.R. § 226.4. One subsection of that regulation—the provision at issue in this case—specifically excludes from the finance charge "[c]harges for unanticipated late payment, *for exceeding a credit limit*, or for delinquency, default, or a similar occurrence." *Id.* § 226.4(c)(2) (emphasis added).

TILA subjects creditors who violate these disclosure requirements to civil liability for actual damages, statutory damages, and reasonable attorney's fees and costs of litigation. *See* 15 U.S.C. § 1640(a). TILA limits statutory damages in class actions to the lesser of $500,000 or one per cent of the creditor's net worth. *See id.* § 1640(a)(2)(B). Recognizing that TILA is "highly technical," S. Rep. No. 93-278, at 13 (1973), Congress amended the statute to provide an exception for creditors who comply in good faith "with any rule, regulation, or interpretation thereof by the Board . . . notwithstanding that after such act or omission has occurred, such rule, regulation, interpretation, or approval is amended, rescinded, or determined by judicial or other authority to be invalid for any reason." 15 U.S.C. § 1640(f). This exception reflects Congress' determination that a creditor should not "be forced to choose between the Board's construction of the Act and the creditor's own assessment of how a court may interpret the Act." S. Rep. No. 93-278, at 13.

2. Credit card accounts generally have credit limits, and it is a violation of the agreement between the customer and the issuing bank for the customer to incur charges over that



limit.[2] Credit limits are set by the bank to limit exposure if the customer does not repay. Over-limit fees serve to enforce these credit limits and compensate the bank for increased risks and costs associated with the breach of a credit limit by a customer. *See* Pet. App. A50. As the TILA legislative history notes, "over-the-limit fees . . . accrue for misuse of the account." S. Rep. No. 100-259, at 6 (1987), *reprinted in* 1988 U.S.C.C.A.N. 3936, 3942. The same rationale underlies the authority of issuing banks to charge late fees on credit card accounts. *See id.*

When a customer presents a credit card to pay for a transaction, the merchant typically (although not always) proceeds through a Visa or MasterCard "authorization" procedure before accepting the card as payment. Authorization involves a communication between the merchant, the merchant's bank, and the Visa or MasterCard computer system, that gives the merchant's bank assurance that the credit card charge will be accepted, in the clearing process, by the bank that issued the consumer's credit card.[3] The Sixth Circuit, which refused the attempt by the Federal Reserve Board, as *amicus curiae*, to explain the matter (*see* Pet. App. A10 n.2), apparently conceived that such authorization constitutes a grant of permission by the issuing bank to the cardholder to exceed the credit limit. *See, e.g., id.* at A12-A13. The assumption is, however, entirely incorrect. The merchant authorization system is not, and

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[2] We describe here over-limit fee practices customary in connection with the credit cards accepted in the Visa and MasterCard payment systems, which is the subject of the Complaint in the present case.

[3] The VISA and MasterCard payment systems process and clear transactions among financial institution members, and are accessible only by those members. Merchants do not have direct access to the VISA and MasterCard payment systems. They make arrangements with financial institutions that are members of VISA or MasterCard, for the right to accept cards that are used in those systems.

cannot be, a means of authorizing customers to exceed their account credit limits.

First, the credit card authorization system cannot, and is not designed to, determine whether a particular charge, at a given time, will cause an account to exceed its credit limit. For a number of reasons, the authorization requests transmitted by merchants do not fully or accurately reflect the actual charges to be posted to a customer's account. In many cases, merchants do not seek authorization for charges to the customer's credit card account while, in other cases, merchants seek approval for transactions that are never carried out. It is also common for the merchant to submit a request for an amount different (either higher or lower) than the actual transaction amount. For example, some merchants submit authorization requests for only a nominal amount simply to verify that the card is "live." Other merchants (e.g., hotels and car rental companies) routinely seek authorizations substantially exceeding any predicted charge amount. Moreover, even if authorization requests fully and accurately represented the actual charges posted to a customer's account, the computer systems used for authorizations do not have continuous real-time information regarding all charges, credits, and payments on an account. Thus, at the time a merchant submits an authorization request, the issuing bank may have "in the pipeline"—but not yet reflected in the authorization system—another charge, a payment, a correction of a prior item, or a "convenience check" or cash-advance check that has not yet cleared the check-processing system. For all of these reasons, it is simply incorrect to assume that the authorization computer systems "know" whether a particular charge will cause a customer's account to exceed its credit limit.

Second, in part because of the unavailability of complete information, and in part for other reasons, issuing banks commonly give authorization for transactions even when they appear likely to be moderately over-limit (to the extent the system can so determine). Cardholders do know what



charges and payments they have actually made, and they have contractually undertaken not to exceed their credit limits. Issuing banks' authorization practices are adapted to avoid refusing to process transactions of responsible customers who are acting in accordance with what they may know to be their actual account status, for example when they know they have a payment in transit. Moreover, issuing banks commonly do not impose over-limit fees on the basis of every individual transaction that causes a customer account to exceed the credit limit at a given time. Rather, they normally impose over-limit fees only when the account balance exceeds the credit limit (or, more typically, exceeds a material margin above the credit limit) at the end of the billing cycle, or for a period of weeks or days. If a customer engages in a transaction that causes the account temporarily to exceed the credit limit (or margin) but makes a payment before the end of the billing cycle or has already made a payment yet to be received, often no over-limit fee is imposed.

Third, the authorization system does not purport to confer any rights on the customer. Visa and MasterCard established their authorization systems to allocate risk and rights *between the merchant's bank and the card-issuing bank* in the event that the issuing bank determines not to honor a charge when it is ultimately presented for payment by the merchant's bank through the clearing system. In general, the issuing bank may not refuse to accept a conforming cardholder charge that it has authorized, but the merchant's bank bears risk if there was no authorization. The cardholder is *not* a participant in these automated authorization communications, nor is the cardholder a party to the contractual relationships and allocations of risk between the merchant bank and issuing bank that are behind the authorization process. Even if the issuing bank has information that a particular charge appears likely to cause a cardholder to exceed his borrowing limit, under ordinary principles the bank's automated confirmation to a merchant

that it will accept the merchant bank's presentation of the charge does not constitute a statement by the bank to its cardholder authorizing the cardholder to exceed that limit.

3. Respondent Sharon Pfennig brought the present putative class action against petitioners Household Credit Services, Inc. and MBNA America Bank, N.A. for violation of TILA with respect to petitioners' method of disclosing over-limit fees. Respondent alleged that petitioners allowed her to exceed the $2,000 credit limit on her credit card account and then charged her an over-limit fee for every month that her balance exceeded that credit limit. *See* Pet. App. A32-A33, A39. According to respondent, petitioners' failure to identify the over-limit fee as part of the finance charge violated TILA. *Id.* at A37-A40. Respondent sought declaratory and injunctive relief, as well as actual damages, statutory damages, and attorney's fees and costs. *See id.* at A40-A41. The district court granted petitioners' motion to dismiss, holding that petitioners properly excluded the over-limit fee from the finance charge pursuant to the plain language of 12 C.F.R. § 226.4(c)(2). *See* Pet. App. at A27-A28.

The Sixth Circuit disagreed. The court conceded that petitioners imposed the over-limit fee because respondent exceeded her credit limit. *See* Pet. App. A17. The court also acknowledged that 12 C.F.R. § 226.4(c)(2) "expressly states that charges imposed for exceeding credit limits are excluded from the 'finance charge.'" Pet. App. A17. The Sixth Circuit nevertheless held that respondents should have included the over-limit fee as part of the finance charge. Based on its view that TILA must be interpreted liberally in favor of consumers, and on respondent's contention that petitioners' acceptance of her credit card charges in the authorization process "allowed" respondent to exceed her credit limit, the court concluded that the over-limit fee was "imposed as an incident to the extension of credit," and therefore fit the statutory definition of a "finance charge."



*See id.* at A8-A9. On this basis, the court held § 226.4(c)(2) of the Board's Regulation Z to be invalid:

> Thus, considering the language in [15 U.S.C.] § 1605(a) defining the finance charge and the language and purpose of TILA as a whole, Regulation Z's exclusion of over-limit fees, such as those imposed in this case, from the "finance charge" conflicts with the express language of TILA. In such instances, the regulation cannot stand.

Pet. App. A12. Having invalidated the regulation excluding over-limit fees from the finance charge, the Sixth Circuit enunciated a new TILA rule of its own making: When a creditor imposes an over-limit fee, that fee must be included in the finance charge if "the creditor knowingly permits the credit card holder to exceed his or her credit limit." *Id.* at A15 n.5. The decision did not state or even consider what circumstances would support a conclusion that a creditor has knowingly permitted a customer to exceed a credit limit.

Based on the TILA good-faith immunity defense of 15 U.S.C. § 1640(f), the Sixth Circuit nevertheless affirmed the dismissal of respondent's claims for monetary damages.[4] The court made one finding that was indispensable to that holding, concluding that it was "undisputed that the fee at issue in this case was imposed for 'exceeding a credit limit.'" Pet. App. A17. As a result, the fee fell within the scope of the Board's regulation excluding over-limit fees from the finance charge. As the Sixth Circuit explained, it was "beyond cavil that [petitioners] complied with Regulation Z and pursuant to 15 U.S.C. § 1640(f) should be afforded immunity from civil damages." Pet. App. A18 n.6; *see also*

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[4] The Sixth Circuit reversed the district court, however, to the extent the lower court dismissed respondent's claims for declaratory and injunctive relief. The Sixth Circuit specifically remanded the case for consideration of those equitable claims. *See* Pet. App. A19.

*id.* at A19 ("[Petitioners] undisputedly relied on the plain language of Regulation Z, which, although it conflicts with the plain language of TILA, expressly excludes fees charged for exceeding a credit limit from the definition of the 'finance charge.'").

## SUMMARY OF ARGUMENT

For over two decades prior to the decision of the Sixth Circuit in this case, banks that issued credit cards relied on 12 C.F.R. § 226.4(c)(2) and excluded over-limit fees from the finance charge in disclosures issued pursuant to TILA, confident that their conduct conformed to the statute and would not lead to civil liability. If the Sixth Circuit decision is not reversed, that confidence will be shattered. By invalidating a regulation, the decision below creates a split in the effective law governing creditors nationwide. While the new Sixth Circuit standard regarding over-limit fees will govern in the four States of that circuit, Regulation Z will continue to apply with the force of law in all other circuits. By thus subjecting the nationwide banking industry to directly conflicting obligations in different parts of the country, the decision below will create substantial compliance problems for issuing banks. Moreover, the Sixth Circuit standard presents its own compliance obstacles. The court failed to clarify the contexts in which an over-limit fee must be included in the finance charge; and credit card authorization systems are not designed to identify precisely and contemporaneously those transactions that cause an account to exceed its credit limit and result in an over-limit fee. The Sixth Circuit decision also promises to make disclosures more difficult (rather than easier) to comprehend, thereby undermining an important objective of TILA. Finally, as the petition argues persuasively, the decision of the Sixth Circuit is wrong. TILA itself distinguishes over-limit fees from the finance charge and, in any event, the Board's regulation setting a bright-line rule to the same effect is surely a reasonable interpretation of the statute.



## ARGUMENT

1. The Court should grant the petition because of the problematic legal conflict created by the decision below. The regulation at issue in this case, 12 C.F.R. § 226.4(c)(2), establishes a bright-line rule that "[c]harges . . . for exceeding a credit limit" shall be excluded from the finance charge for purposes of TILA disclosures. By invalidating that federal regulation, the Sixth Circuit has created a conflict in the effective law governing creditors' disclosure obligations nationwide. Outside the Sixth Circuit, creditors must continue to abide by § 226.4(c)(2) and disclose any over-limit fees imposed as an "other charge" separate and distinct from the finance charge. *See* 12 C.F.R. §§ 226.6(b), 226.7. In the Sixth Circuit, however, creditors are subject to a directly conflicting standard: an over-limit fee must be disclosed as part of the finance charge whenever the "creditor knowingly permit[ted] the credit card holder to exceed his or her credit limit." Pet. App. A15 n.5. Thus, regardless of whether there is a split in judicial decisions concerning the validity of § 226.4(c)(2), nationwide creditors are subjected to conflicting legal obligations.

This conflict is more than theoretical. Credit card issuers and other creditors must establish systems to ensure that solicitations, initial disclosures, and periodic billing statements all comply with two incompatible rules. This will require banks not only to identify initially which is the appropriate governing law (either Regulation Z, or else the Sixth Circuit standard) with regard to each particular customer (or individual transaction). It may also require issuing banks to revise previously-provided "initial disclosures," in all instances when the Sixth Circuit rule applies, to explain to cardholders when over-limit fees will in the future be imposed as "finance charges" and when as "other charges." Needless to say, such new processes and disclosures will be tremendously complex, uncertain, confusing to consumers, and expensive. Congress recognized in delegating broad rulemaking power to the

Board that it was important "for uniformity of application to all affected segments of the industries concerned [that] a single set of comprehensive regulations should be issued." H.R. Rep. No. 90-1040, *reprinted in* 1968 U.S.C.C.A.N. at 1975. The uniformity of application achieved by Regulation Z—and now upset by the Sixth Circuit decision—can only be preserved if this Court grants the petition.

To make matters worse for issuing banks, it is unclear when a particular disclosure is to be governed by Regulation Z, and when by the new Sixth Circuit standard. For example, the choice of which rule governs could depend on a number of possibilities, including the location of the issuing bank, the residence of the cardholder, or even the location of the court in which litigation involving an over-limit fee is initiated. If the last factor were determinative, a disclosure to a particular customer might be held unlawful no matter which rule a bank follows. TILA class actions on behalf of cardholders can be filed in district courts either within or outside the Sixth Circuit. If a class action were filed outside the Sixth Circuit, the court would presumably hold that over-limit fees are required to be *excluded* from the finance charge, as Regulation Z dictates, *see* 12 C.F.R. § 226.4(c)(2). If, however, the action were filed in a district court within the Sixth Circuit, the same over-limit fees may have to be *included* in the finance charge.[5] Issuing banks cannot comply with both rules simultaneously; but complying with *either* Regulation Z or the Sixth Circuit standard could subject them to substantial statutory damages

[5] This potential predicament is highlighted by the facts of the present case. Respondent brought a class action on behalf of *all* consumers who hold credit cards issued by petitioners and who have been subjected to an over-limit fee. *See* Pet. App. A34. Unless reviewed by this Court, the Sixth Circuit's decision may conceivably be held to govern the claims of all class members on remand regardless of whether they reside in the Sixth Circuit.



in a class action in one district or another. *See* 15 U.S.C. § 1640(a)(2)(B).[6]

2. The new Sixth Circuit standard also presents severe practical problems on its own terms. According to the decision below, creditors must disclose over-limit fees as part of the finance charge when "the creditor *knowingly permits* the credit card holder to exceed his or her credit limit." Pet. App. A15 n.5 (emphasis added). But credit card authorization systems are not today designed to create and record the kind of information necessary for such determinations. Banks may therefore be required to develop new computer systems to attempt to identify instances in which any record at the time of authorization might have reflected a potential basis for "knowing" that a transaction was over-limit, and to verify whether the transaction actually was over-limit. This, in turn, would seemingly require the development of systems capable of determining (in hindsight) whether an over-limit fee is properly attributable to a particular transaction. In those instances when an over-limit fee can be traced to a "knowing" over-limit transaction, banks' operational systems would presumably need to treat the over-limit fee as part of the "finance charge," and at the same time to treat all other over-limit fees as "other charges." The development of such new and complex systems would

[6] Apart from the fact that Regulation Z remains good law outside the Sixth Circuit, issuing banks have an additional reason to comply with 12 C.F.R. § 226.4(c)(2) in those jurisdictions. While creditors are entitled to immunity from monetary liability for actions taken in good-faith reliance on "any rule, regulation, or interpretation thereof by the Board," 15 U.S.C. § 1640(f), courts have held that TILA does not protect actions taken in reliance on *judicial* interpretations of the statute. *See, e.g., Hamilton* v. *Southern Discount Co.*, 656 F.2d 150, 152 (5th Cir. Unit B Sept. 1981). Thus, with respect to lawsuits filed outside the Sixth Circuit, only compliance with § 226.4(c)(2) would enable the banks to claim good-faith immunity under TILA. Following the Sixth Circuit standard on a nationwide basis simply is not a viable option.

impose enormous costs. Banks may therefore decide simply to change their substantive practices regarding when to apply an over-limit charge, notwithstanding the fact that TILA was not intended to govern the substantive terms of the creditor-debtor relationship.

Moreover, the new Sixth Circuit rule is unclear. It is quite certain that the Sixth Circuit has held that the Board's regulation is unlawful and "cannot stand." Pet. App. 12. But it is uncertain what the Sixth Circuit has replaced it with. The court did not indicate what it means to "knowingly permit" a customer to exceed a credit limit. *See id.* at A10 n.2. As explained above, mere authorization by an issuing bank, assuring a merchant that the bank will accept a charge, has no bearing on the quite separate contractual relationship between the issuing bank and the cardholder that obligates the cardholder to stay within his credit limit. The Sixth Circuit noted respondent's contention that petitioners permitted charges that exceeded respondent's credit limit (*see id.* at A15 n.5 (citing Complaint ¶¶ 34-35; Pet. App. A39)), yet the court reinterpreted this process as petitioners having "renegotiate[d]" the agreement with respondent. *Id.* at A13. The court did so apparently based on factual assumptions that were found nowhere in the complaint, and were contrary to the Federal Reserve's explained justification of its regulatory approach. *See, e.g., id.* at A12-A13. Because there is a difference between the authorization process as it actually works, and the Sixth Circuit's conceptions about it, it is quite unclear how the Sixth Circuit's rule is supposed to work in the world that actually exists. Absent further litigation—and the attendant risk of civil liability—banks cannot know what facts will satisfy the Sixth Circuit's "knowingly permits" standard and thereby require inclusion of an over-limit fee in the finance charge. This, in turn, will make the already complicated process of reconfiguring computer systems to account for the new Sixth Circuit standard even more difficult.



3. The practical effects of the Sixth Circuit's decision described herein also directly undermine TILA's own objectives. Congress determined—both in amending TILA to add a defense for good-faith reliance on the Board's regulations and in enacting the Simplification Act—that it should not be made difficult for creditors to determine how to comply with TILA. *See Milhollin*, 444 U.S. at 566 ("Because creditors need sure guidance through the 'highly technical' Truth in Lending Act, legislators have twice acted to promote reliance upon Federal Reserve pronouncements.") (citation omitted); S. Rep. No. 96-73, at 2, *reprinted in* 1980 U.S.C.C.A.N. at 280 (describing Simplification Act as amending the Truth in Lending Act to, *inter alia*, "make creditor compliance easier"); S. Rep. No. 93-278, at 13 ("The Truth in Lending Act is highly technical and the Committee does not believe a creditor should be forced to choose between the Board's construction of the Act and the creditor's own assessment of how a court may interpret the Act."). The Sixth Circuit decision runs directly counter to this TILA objective. Not only does the decision make compliance more (not less) difficult for creditors but, by displacing a clear and uniform regulation of the Board with a vague and fact-intensive standard, it leaves creditors to guess (and litigate) about the specific contours of the new "knowingly permits" standard.

That requirements be predictable and clear, as a context for parties' transactions and communications, is one of the foremost considerations in the field of banking regulation. As this Court has recognized, "[b]anking is one of the longest regulated and most closely supervised of public callings," *Fahey v. Mallonee*, 332 U.S. 245, 250 (1947); and in part because banking deals in intangibles, the rights, obligations, and relationships among parties are shaped by regulatory context to an extent that perhaps exceeds any other field. On many banking matters—especially patterned disclosure regimes like TILA—the predictability and clarity of bright-line rules are in many regards more important than perfect

"accuracy" of fact-specific determinations such as the Sixth Circuit may desire. Congress expressly recognized this point in enacting TILA, granting the Board broad power to promulgate regulations containing "classifications, differentiations," and "adjustments and exceptions for any class of transactions . . . to facilitate compliance therewith." 15 U.S.C. § 1604(a). The Sixth Circuit, by rejecting the bright-line approach the Board had adopted in Regulation Z's treatment of over-limit fees, disserved important congressional objectives in an area where they are most dearly needed.

Indeed, one of the most important objectives of TILA, and especially the Simplification Act, was to assure disclosure of credit terms in simple and clear forms that would enable consumers more readily to compare available credit terms. *See, e.g., id.* § 1601(a). The legislative history to the original statute noted that "[i]n many instances today, consumers do not know the costs of credit. Charges are often stated in confusing and misleading terms. . . . As a matter of fair play to the consumer, the cost of credit should be disclosed fully, simply, and clearly." H.R. Rep. No. 90-1040, *reprinted in* 1968 U.S.C.C.A.N. at 1965; *see also* S. Rep. No. 96-73, at 3, *reprinted in* 1980 U.S.C.C.A.N. at 281 (noting that one goal of Simplification Act was to "provid[e] the consumer with simpler, more understandable information"). The decision of the Sixth Circuit disserves this objective by eliminating the clear, uniform treatment of over-limit fees under 12 C.F.R. § 226.4(c)(2) in favor of a fact-specific standard that requires creditors to include over-limit fees as part of the finance charge sometimes, and exclude them from the finance charges at other times. The distinctions between the two situations will virtually never be understandable to the consumer reviewing a monthly billing statement and it will become *more* difficult for consumers to compare effectively the charges imposed by two different creditors.



4. The Court should also grant the petition because the decision of the Sixth Circuit is importantly wrong, both in substance and in failing to accord the Board's regulation the deference it is due. In invalidating 12 C.F.R. § 226.4(c)(2), the Sixth Circuit purported to find clear congressional intent where at most only ambiguity exists, and it ignored the applied expertise of the Board in an area where Congress charged the agency with unusually broad regulatory authority and discretion. The petition already demonstrates well the reasons why the decision below should be reversed, and those arguments will not be repeated here. One argument not made by the petition, however, additionally illuminates the error of the Sixth Circuit's refusal to defer to the Board.

TILA itself reflects, at the least, ambiguity regarding whether ordinary over-limit fees should be considered part of the finance charge. This ambiguity can be seen in TILA's disclosure obligations for applications and solicitations, which are found in 15 U.S.C. § 1637(c). Those requirements apply both to credit cards and charge cards, and the difference between the two is significant because the statute defines a "charge card" as "a card, plate, or other single credit device that may be used from time to time to obtain credit *which is not subject to a finance charge*." 15 U.S.C. § 1637(c)(4)(E) (emphasis added). Notwithstanding that charge cards are defined as accounts that do not have finance charges (normally these accounts are paid in full each month), TILA recognizes that over-limit fees may occur on charge cards, and it requires that solicitations and applications for charge cards disclose any "[o]ver-the-limit fee." 15 U.S.C. § 1637(c)(1)(B)(iii), (c)(4)(B)(iii). This is the only place TILA speaks to the issue, and it indicates that Congress itself conceived it rational to treat over-limit fees as not being finance charges. While these statutory provisions may not *require* the regulatory treatment of over-limit fees that the Board adopted, they surely should have caused the Sixth Circuit to recognize that the Board's regulation is reasonable and permissible under the well-established rules

governing deference to administrative rulemaking. *See, e.g.*, *Chevron, U.S.A., Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984); *Milhollin*, 444 U.S. at 565-66.

As this Court has noted, the Board's power to promulgate regulations under TILA is even broader than that of the traditional federal agency. *See Ragsdale* v. *Wolverine World Wide, Inc.*, 122 S. Ct. 1155, 1163 (2002). Indeed, TILA provides that the Board's regulations "may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this subchapter, to prevent circumvention or evasion thereof, or to facilitate compliance therewith." 15 U.S.C. § 1604(a). The Sixth Circuit erred by effectively granting no deference to the Board's reasonable interpretation here. In doing so, the decision below affects a substantial federal interest. The Board appeared as an *amicus curiae* at the rehearing stage below to make this very point. *See* Pet. App. A43-A53. The present *amici* believe that the Sixth Circuit's decision warrants review by this Court. *Amici* also concur, however, with petitioners that at a minimum the Court should call for the views of the Solicitor General to permit a presentation of the Board's perspective. *See* Pet. 3.

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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# In the Supreme Court of the United States

HOUSEHOLD CREDIT SERVICES, INC. AND MBNA AMERICA BANK, N.A., PETITIONERS

*v.*

SHARON R. PFENNIG

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT*

## BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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## QUESTION PRESENTED

Whether the Federal Reserve Board reasonably classified a fee imposed by a credit card lender because a consumer has exceeded the credit limit as one of the "other charges which may be imposed" under the account (15 U.S.C. 1637(a)(5)) rather than as a "finance charge" (15 U.S.C. 1605(a)), within the meaning of the Truth in Lending Act, 15 U.S.C. 1601 *et seq.*

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## BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

This brief is submitted in response to the Court's order inviting the Solicitor General to express the views of the United States. The decision below invalidating an important federal regulation is wrong, creates significant practical difficulties for the credit card industry, and will produce consumer confusion. This Court should grant the petition for a writ of certiorari.

## STATEMENT

1. a. The Truth in Lending Act (TILA), 15 U.S.C. 1601 *et seq.*, establishes a comprehensive scheme that requires lenders to disclose credit terms to consumers. The disclosures for open-end credit plans, such as the credit card account in this case, vary depending on the stage in the

lending process and include various items, including the "finance charge" (15 U.S.C. 1605(a)), the "annual percentage rate" (APR) (15 U.S.C. 1606(a)), and the fee at issue here —an over-the-credit-limit (OCL) fee, which is "imposed in connection with an extension of credit in excess of the amount of credit authorized to be extended with respect to such account" (15 U.S.C. 1637(c)(1)(B)(iii)).

The "finance charge" is "the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit." 15 U.S.C. 1605(a). Although TILA gives examples of charges that must be included in the finance charge and charges that may or must be excluded, OCL fees are not mentioned in either category. 15 U.S.C. 1605. The APR for an open-end plan is "the quotient (expressed as a percentage) of the total finance charge for the period to which it relates divided by the amount upon which the finance charge for that period is based, multiplied by the number of such periods in a year." 15 U.S.C. 1606(a)(2). Thus, when a finance charge for a given period includes a fee in addition to the application of an interest rate to an outstanding amount, such as a cash advance fee, the APR for the period generally increases to reflect that fee.

Creditors must make disclosures to consumers in solicitations or applications, again before opening the account, and for each billing cycle under the plan. Direct-mail applications and solicitations must inform consumers of the APRs that may apply under the plan, 15 U.S.C. 1637(c)(1)(A), and must specify certain other fees that may be assessed under the plan, including late fees and OCL fees, 15 U.S.C. 1637(c)(1)(B). Additional disclosures before opening the account must identify the conditions under which a finance charge may be imposed, the method of determining the balance on which a finance charge will be imposed and the amount of the finance charge, and the nominal APR that will



be applied to balances. 15 U.S.C. 1637(a)(1)-(4). Creditors must also identify "other charges which may be imposed as part of the plan." 15 U.S.C. 1637(a)(5). For each billing cycle, the creditor must provide a periodic statement informing the consumer of, among other things, the outstanding balance, an itemization of the extensions of credit during the billing cycle, the amount of any finance charge added to the account during the billing cycle, and the total finance charge expressed as an APR. 15 U.S.C. 1637(b).

b. TILA requires the Board of Governors of the Federal Reserve System (Board) to issue regulations to carry out its purposes. Those regulations "may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of [the Act], to prevent circumvention or evasion thereof, or to facilitate compliance therewith." 15 U.S.C. 1604(a). Creditors who act in good faith reliance on a rule, regulation, or interpretation by the Board or its staff are protected from liability under the civil liability provisions of TILA, even if the rule or interpretation in question is later rescinded by the Board or held invalid by a court. 15 U.S.C. 1640(f).

The Board's Regulation Z, adopted pursuant to Section 1604(a), provides that OCL fees, which it describes as "[c]harge[s] * * * for exceeding a credit limit," as well as fees for late payment, delinquency, default, and similar occurrences, are not included in the finance charge. 12 C.F.R. 226.4(c)(2). The express exclusion of OCL fees from the finance charge dates from a 1981 revision to the regulation, see 46 Fed. Reg. 20,894 (1981), but the Board and its staff had interpreted the prior regulatory language to provide for the same result. See Official Interpretive Letter FC-0142 (Fed. Reserve Bd. Jan. 9, 1978); Unofficial Staff Interpretation PI-1281 (Fed. Reserve Bd. Feb. 14, 1978).

In accordance with TILA, Regulation Z requires creditors to make disclosures with direct-mail applications or solicitations, before the initial use of a credit card plan, and with each billing cycle. 12 C.F.R. 226.5a, 226.6, 226.7. Although Regulation Z does not require those disclosures to include OCL fees in the finance charge or APR, it requires all of the disclosures to identify any OCL fee as a charge other than a finance charge. 12 C.F.R. 226.5a(b)(10) (direct mail solicitations); 12 C.F.R. 226.6(b) (initial disclosures); 12 C.F.R. 226.7(h) (periodic statement). See 12 C.F.R. Pt. 226 Supp. I, Official Staff Interpretations, Cmts. 6(b)-1(i), 7(h)-4 (requiring OCL fees to be disclosed as "other charges" on initial and periodic disclosures).

2. a. Respondent Sharon Pfennig is a consumer who holds a credit card account originally issued by an affiliate of petitioner Household Credit Services, Inc., and now held by petitioner MBNA America Bank, N.A. On behalf of a purported nationwide class of petitioners' customers, respondent sued petitioners in the United States District Court for the Southern District of Ohio. Pet. App. A31-A41. Respondent alleged that petitioners violated TILA when they allowed her to incur charges that caused her balance to exceed her credit limit, imposed an OCL fee, and failed to disclose the OCL fee as a finance charge or to include it in the APR on her periodic statement. *Id.* at A32-A33, A39-A40. Respondent did not allege that petitioners failed to disclose the OCL fee as an "other charge," as required by Regulation Z.

The district court granted petitioners' motion to dismiss the complaint. Pet. App. A24-A29. The court observed that Regulation Z specifically provides that an OCL fee is not a finance charge. *Id.* at A27. The court noted that the regulation excludes from the finance charge several fees, including late fees, delinquency charges, and OCL fees, "all of which arise when the terms under which the credit was



extended have been breached by the borrower." *Id.* at A28. The court concluded that the "Board rationally determined that those charges, for acts amounting to breaches of the agreed upon credit extension, are not finance charges." *Ibid.* Accordingly, the court deferred to the Board's regulation, as required under *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555 (1980), and held that petitioner's complaint fails to state a claim upon which relief can be granted. Pet. App. A28.

b. A divided panel of the United States Court of Appeals for the Sixth Circuit reversed. Pet. App. A1-A23. The court acknowledged its obligation under this Court's decisions to give "deference * * * to the [Board]'s interpretation of [TILA] as long as such interpretations are not irrational." *Id.* at A6. Nonetheless, the court of appeals declined to defer to Regulation Z's provision that OCL fees are not part of the finance charge. *Id.* at A8-A15.

The court of appeals first stated that, "as a remedial statute, [TILA] must be given a liberal interpretation in favor of consumers." Pet. App. A8. The court then went on to conclude that the OCL fee imposed here "falls squarely within the statutory definition of a finance charge." *Id.* at A9. The court noted that TILA defines the finance charge as "the sum of '*all charges*'" paid by the borrower and assessed by the creditor "as an incident to the extension of credit." *Ibid.* The court read respondent's complaint to allege that she was charged OCL fees after she requested and was granted additional credit, because the complaint alleged that petitioners allowed her to incur the charge that caused her account to exceed the credit limit. *Ibid.* The court stated that, "under a plain reading of § 1605(a) and the general rules of statutory interpretation, the [OCL] fee was imposed incident to the extension of credit to [respondent]." *Ibid.* The court concluded that "Regulation Z's exclusion of over-limit fees, such as those imposed in this case, from the 'finance charge' conflicts with the express language of

TILA," and "the regulation cannot stand." *Id.* at A12. The court noted, however, that its holding applies only when "the creditor knowingly permits the credit card holder to exceed his or her credit limit." *Id.* at A15 n.5.[1]

Chief District Judge Edgar (sitting by designation) dissented from the court's holding that Regulation Z is invalid. Pet. App. A19-A23. Observing that OCL fees are not mentioned in TILA's definition of "finance charge," Judge Edgar reasoned that, although the panel majority's interpretation of the statutory language "might well be a reasonable one," the Board's reading is also reasonable. *Id.* at A22. In his view, the Board reasonably analogized OCL fees to other charges, such as those for late payment or delinquency, that "are clearly not a part of the finance charge because they are, as the district court concluded, post extension of credit occurrences." *Ibid.* Judge Edgar noted that, in *Milhollin*, this Court held that the Board's regulations construing TILA are "dispositive" unless "demonstrably irrational." *Ibid.* (quoting *Milhollin*, 444 U.S. at 565). He further noted that the court of appeals' decision "effectively amends Regulation Z in [the Sixth Circuit]," and thereby breaches "[t]he national uniformity established by the [Board] for consumer credit." *Id.* at A22-A23. Judge Edgar would instead have deferred to the Board's regulation as a reasonable interpretation of TILA. See *id.* at A23.

Petitioners sought rehearing and rehearing en banc, and the Board filed an amicus brief in support. Pet. App. A43-A53. The Board's brief explained that its regulation reflects the circumstances under which OCL fees are generally imposed. In particular, the Board explained that creditors

[1] Although it invalidated Regulation Z as applied to the OCL fees in this case, the court concluded that petitioners were entitled to immunity from money damages under 15 U.S.C. 1640(f) because they had relied in good faith on the regulation. Pet. App. A15-A18.



almost never have the real-time information necessary to determine whether a particular credit transaction for which approval is being sought will actually cause a consumer to exceed a credit limit. *Id.* at A48-A50. For that reason, when a creditor authorizes a transaction that will ultimately cause the consumer to exceed the credit limit, the creditor is not generally knowingly extending credit in excess of the limit. Creditors therefore do not impose OCL fees until the conclusion of the billing cycle, and the decision to impose the fee is based on a backward look at the account history. *Id.* at A50-A51. The Board also explained that the court's decision would create serious compliance difficulties for creditors and confusion among consumers. *Id.* at A51-A52.

The court denied panel rehearing but amended its opinion to add a footnote that rejected the Board's arguments. See Pet. App. A10-A11 n.2. The court dismissed the Board's explanation of industry practice and the reasons for the regulation as facts that "were never raised below and are not in the record." *Id.* at A10 n.2. The court suggested that concerns about the invalidation of the regulation could be addressed at trial, at which time petitioners could challenge respondent's allegations that they knowingly allowed her to exceed her credit limit by permitting her to incur the charge that had that result. *Id.* at A11 n.2. The full court later denied the petition for rehearing en banc. *Id.* at A30.

## DISCUSSION

This Court should grant the petition for a writ of certiorari. The court of appeals incorrectly held that TILA demands disclosure of the OCL fees imposed in this case as a finance charge. In so doing, the court erroneously invalidated an important Board regulation that sets clear and uniform national standards for nationwide creditors. The decision will result in conflicting disclosure requirements that seriously burden the credit card industry, create con-

fusion for consumers, and undermine TILA's goal of a coherent system of uniform disclosures. The issue is important, and its resolution by this Court is warranted.

## I. THE COURT OF APPEALS ERRED IN INVALIDATING THE BOARD'S REGULATION EXCLUDING OCL FEES FROM THE FINANCE CHARGE

### A. The Regulation Reasonably Resolves Ambiguity In TILA

1. TILA does not directly address whether OCL fees should be disclosed as part of the finance charge or instead as other charges that may be incurred under a credit card plan. TILA defines the "finance charge" to include "all charges" imposed on the consumer by the creditor "as an incident to the extension of credit." 15 U.S.C. 1605(a). But TILA makes clear that not every charge associated with a credit agreement is "incident to the extension of credit." The Section defining "finance charge" lists "examples" of charges included in the finance charge and identifies some charges connected with the extension of credit that are not included. See 15 U.S.C. 1605. Neither the "examples" nor the express exclusions would be necessary if all charges connected with the extension of credit were included. Likewise, the Section prescribing disclosures for open-end credit plans, such as credit card accounts, requires separate disclosure of "other charges which may be imposed as part of the plan" in addition to the finance charge. 15 U.S.C. 1637(a)(5).

Equally important, in the specific circumstances where TILA addresses OCL fees and requires their disclosure, it does not classify them as finance charges. See 15 U.S.C. 1637(c)(1)(b)(iii) (direct-mail applications and solicitations for credit card accounts); 15 U.S.C. 1637(c)(4)(B)(iii) (written applications and solicitations for charge cards). Although Congress was clearly aware of OCL fees, it did not address their treatment in the definition of finance charge nor



elsewhere classify OCL fees as finance charges, despite the fact that it expressly addressed the treatment of various other fees. See 15 U.S.C. 1605.

2. Because TILA itself does not address the proper classification of OCL fees, the Board, in its implementing regulations, had to decide whether to classify such fees as part of the "finance charge" (15 U.S.C. 1605(a)) or instead as one of the "other charges which may be imposed as part of the [credit] plan" (15 U.S.C. 1637(a)(5)). TILA gives the Board broad authority to make "such classifications * * * as in the judgment of the Board are necessary or proper to effectuate [TILA's] purposes." 15 U.S.C. 1604(a). Exercising that authority, the Board reasonably classified OCL fees, like other fees imposed because a consumer violates the terms of the credit agreement, as "other charges" rather than part of the "finance charge."

That determination is embodied in Regulation Z's exclusion from the finance charge of "[c]harges for actual unanticipated late payment, for exceeding a credit limit, or for delinquency, default, or a similar occurrence." 12 C.F.R. 226.4(c)(2). Those fees must instead be disclosed separately as "other charges." 12 C.F.R. Pt. 226 Supp. I, Official Staff Interpretations, Cmts. 6(b)-1(i), 7(h)-4.

The Board's determination reflects that those fees are not imposed when credit is extended in accordance with the terms of the agreement but are imposed only if the consumer violates the agreement. For the creditor, the fees serve important functions apart from compensating for increased credit risk resulting from the higher balance. They deter consumers from violating the agreement and compensate the creditor for the additional risk inherent in dealing with a consumer who does not abide by the agreement's terms. For the consumer, such fees are not integral to the cost of credit under the agreement, because the consumer will not incur them by borrowing in accordance with the agreement. The

Board reasonably concluded that consumers will find the finance charge more meaningful when comparing credit costs if it is calculated based on the assumption that consumers comply with the terms of their credit agreements. The Board also reasonably concluded that treating these penalty-type fees uniformly, rather than distinguishing among them in ways that may not be significant to consumers and to creditors, will best facilitate consumer understanding and industry compliance.

### B. The Court Of Appeals Failed To Accord The Board's Regulation The Deference Required By This Court's Cases

1. Under this Court's precedents, the court of appeals should have deferred to the Board's reasonable regulation. As a general matter, when a statute is "silent or ambiguous with respect to the specific issue" covered by an authorized and validly promulgated regulation, courts must defer to the regulation if it is "based on a permissible construction" of the statute. *Chevron U.S.A., Inc.* v. *Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843 (1984). That principle has heightened force in the context of regulations issued by the Board under TILA.

As this Court has explained, TILA gives the Board unusually "broad administrative lawmaking power." *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 566 (1980). Moreover, in recognition of both the Board's central role and the need for uniformity in this area, TILA provides creditors a defense from liability if they comply in good faith with a Board "rule, regulation, or interpretation" or an official interpretation by Board staff. 444 U.S. at 567 (quoting 15 U.S.C. 1640(f)). Congress thus has expressed "a decided preference for resolving interpretive issues by uniform administrative decision, rather than piecemeal through litigation." *Id.* at 568. Deference to the Board is also "compelled by



necessity" because the goal of "meaningful disclosure" that animates TILA requires a policy balance between "complete disclosure" and "informational overload." *Ibid.* The Board is better suited than the courts to strike the appropriate balance, because doing so "entails investigation into consumer psychology" and requires "broad experience with credit practices." *Id.* at 568-569.

For those reasons, this Court has held that, "[u]nless demonstrably irrational," constructions of TILA by the Board or its staff "should be dispositive." *Milhollin*, 444 U.S. at 565. Thus, "absent some obvious repugnance to the statute, the Board's regulation implementing [TILA] should be accepted by the courts." *Anderson Bros. Ford* v. *Valencia*, 452 U.S. 205, 219 (1981).

2. Although the court of appeals cited *Milhollin* and *Valencia*, see Pet. App. A5-A6, the court did not afford the Board's regulation the deference that those cases require. Rather, the court classified TILA as "a remedial statute" and purported to give it "a liberal interpretation in favor of consumers to protect them in credit transactions." *Id.* at A8-A9. By applying that rule of construction, the court usurped the Board's role in "strik[ing] the appropriate balance" between "complete disclosure" and "informational overload." *Milhollin*, 444 U.S. at 568. In the Board's view, the interpretation adopted by the court of appeals is not more protective of consumers and indeed will produce substantial confusion among consumers. And, in any event, it is for the Board, and not the courts, to decide how such policy considerations should influence interpretation of ambiguities in TILA.

The court rejected the Board's determination that OCL fees should be treated like other fees imposed for consumer violations of the credit agreement, such as fees for late payment, delinquency, or default. The court reasoned that those other fees are imposed when the consumer "*unexpectedly*"

violates the agreement, but the OCL fees here were imposed after the creditor allegedly permitted the consumer to incur charges that caused her to exceed the credit limit. Pet. App. A14. When "the creditor knowingly permits the credit card holder to exceed his or her credit limit" and then imposes an OCL fee, the court reasoned, the OCL fee is, in that circumstance, although not in others, "incident to the extension of that credit." *Id.* at A15 n.5.

But nothing in TILA requires that the finance charge include a fee for violating the credit agreement simply because the breach of the agreement is not unexpected. The court's rule, which distinguishes OCL fees from one another based on the creditor's subjective knowledge at the time that the over-limit transaction occurs, finds no support in TILA's text. Moreover, it reflects a fundamental misunderstanding of the ordinary operation of the credit card industry and would frustrate, rather than effectuate, the purposes of TILA.

The court premised its holding that the OCL fee at issue here was "incident to the extension of credit" on respondent's allegation that the fee was imposed because petitioners knowingly allowed charges to her account that caused her to exceed the credit limit. See Pet. App. A13, A15 n.5. But no language in TILA's definition of finance charge suggests that whether a fee is a finance charge should turn on the creditor's subjective knowledge of the consumer's current account status. See 15 U.S.C. 1605(a).

Further, the court mistakenly assumed that authorization of an over-limit transaction is equivalent to a renegotiation of the credit limit and an agreement to extend additional credit. See Pet. App. A9, A12-A13, A14, A15 n.5. Contrary to that assumption, authorization of an over-limit transaction typically is not a "renegotiation" of the credit limit and does not evince the creditor's knowledge of or acquiescence in the consumer's violation of the credit agreement.



The point-of-sale authorization process permits a merchant to check whether the card is stolen, the account has been terminated, or transactions on the account have been blocked. But the authorization process is not designed to, and does not generally, indicate to either the merchant or the creditor whether a transaction will cause a consumer to exceed the credit limit. That is so for several reasons: Payments or refunds may have been received, or additional charges may have been incurred, but not yet posted. In addition, merchants frequently seek authorization for amounts that do not reflect actual charges. Some merchants seek authorization for a nominal amount to determine whether a consumer has a "live" card; others, such as hotels and car rental facilities, block large amounts of credit on check-in to ensure that payment will be authorized on check-out. Pet. App. A49-A50.

A creditor who declines to authorize a transaction because it is potentially over the credit limit based on information in the authorization database may cause needless hardship and embarrassment to cardholders and deny credit transactions to which cardholders may be entitled by contract. The same limitations that would cause these mistaken credit denials also prevent creditors from determining in real time that a transaction is over the limit for purposes of imposing an OCL fee. For that reason, creditors do not impose OCL fees at the time that they authorize a transaction that may cause the balance to exceed the limit. Instead, they determine whether to impose an OCL fee at the end of the billing cycle, when they can ascertain whether, in light of all charges and credits, the consumer has in fact exceeded the credit limit, and when they can consider other factors, such as the consumer's payment history, the amount by which the limit is exceeded, and how long the account was in over-limit status. Pet. App. A50. For those reasons, the Board has never placed any significance on what the merchant

authorization process might indicate about the possibility that an OCL fee will later be imposed. Instead, the Board has rationally characterized all OCL fees as charges for violating the credit agreement rather than finance charges.

The court of appeals apparently declined to consider the ordinary operation of the credit card industry because it construed respondent's complaint to allege that the OCL fees here were imposed after petitioners approved a transaction with actual knowledge that it would cause respondent to exceed her credit limit. Pet. App. A10-A11 n.2, A15 n.5. The court suggested that petitioners could avoid liability if they establish at trial that they lacked such knowledge. *Id.* at A11 n.2. But that suggestion misses the point: Based on the ordinary operation of the credit card industry and the general characteristics of OCL fees, the Board rationally determined that such fees are not part of the finance charge, whether or not the creditor knowingly approved the transaction that caused the consumer to exceed the credit limit.[2]

The court's decision to reject the Board's reasonable determination and instead to distinguish between OCL fees on the basis of the creditor's "knowledge" is not only unsupported by TILA but would cause consumer confusion and

[2] The court's statement (Pet. App. A10) that the Board conceded that there may be instances when an OCL fee is a finance charge is not correct. The court relied on a footnote in the Board's amicus brief that observes in passing that an OCL fee may not be bona fide in certain limited circumstances. See *id.* at A50-A51 n.8. The Board's brief refers to a situation where a charge is mislabeled as an OCL fee when it is not in fact a penalty imposed for breaching the agreement but is imposed for some other reason. The court seized on that statement as a concession that there were in fact questions for trial. *Id.* at A10. As the Board carefully pointed out in its brief, however, there is no allegation in this case that fees charged respondent were anything other than bona fide OCL fees. Indeed, the Sixth Circuit itself accepted that the fees imposed here were bona fide OCL fees within the meaning of Regulation Z in holding that petitioners are entitled to immunity from damages. *Id.* at A17.



frustrate TILA's purposes. An attempt to tune the disclosure instrument so finely would lead to "informational overload" that would confuse consumers rather than enlighten them. *Milhollin*, 444 U.S. at 568. A consumer who incurs OCL fees could receive some periodic statements in which the fee is disclosed as an "other charge" and other statements in which the fee is disclosed as a "finance charge." The consumer would likely be puzzled by different treatment of fees that from her point of view result from the same action. Pet. App. A51-A52.

Requiring creditors to distinguish in disclosing OCL fees on the basis of the creditor's "knowledge" would also substantially burden card issuers. Issuers would have to design and adopt complex systems to draw lines between OCL fees imposed following a "knowing" authorization and those imposed in the more common "unknowing" circumstances. Issuers would also bear substantial litigation risk from the inherent uncertainty about the precise location of such lines. Creditors face statutory damages for violations of TILA or Regulation Z equal to twice the finance charge for the transaction (up to the lesser of $500 thousand or 1% of the creditor's net worth in the case of class actions), and also must pay the costs of the action and attorneys' fees. 15 U.S.C. 1640(a). Incorrectly placing a "finance charge" in the "other charge" category subjects the lender to liability for misstating the amount of the finance charge. See 12 C.F.R. 226.7(f); 15 U.S.C. 1640(a). If the APR is overstated or understated by more than 1/8 of one percent, that, too, is a violation. See 12 C.F.R. 226.14(a).

The statutory and regulatory scheme places a premium on clear classification rules that give the regulated community the necessary notice to comply. The Sixth Circuit's case-specific, knowledge-based standard is inconsistent with that scheme. With the costs of misclassification so high, and little or no benefit to consumers from a classification scheme as

finely calibrated as the Sixth Circuit's, the Board rationally adopted a simple rule that classifies all OCL fees as "other charges." The court of appeals erred in invalidating that rule.

## II. THE COURT OF APPEALS' DECISION WARRANTS THIS COURT'S REVIEW

This Court should grant the petition for a writ of certiorari and reverse the erroneous decision of the Sixth Circuit. The decision creates conflicting disclosure rules that will burden credit card lenders, expose lenders to significant liability, confuse consumers, and impair the effective administration of Regulation Z.

1. By invalidating the Board's regulation, the Sixth Circuit has created conflicting disclosure regimes that will seriously burden credit card lenders. Because the Sixth Circuit's disclosure rule is directly contrary to the demands of Regulation Z, a lender cannot comply with one of the rules without violating the other. Yet a substantial number of credit card lenders operate nationwide or in multistate regions. See Federal Reserve, *Survey of Credit Card Plans* (last modified Jan. 31, 2003) <http://www.federalreserve.gov/pubs/shop/tablwb.pdf>. The need to comply with two contrary disclosure rules in a nationwide market would itself create significant burdens for lenders. But the actual burden is far greater than just having to comply with Regulation Z in some discrete, clearly-defined situations and the Sixth Circuit rule in others, because there is no clear way for a lender to determine in advance which rule applies in a particular situation.

The Sixth Circuit rule might apply to lenders located in the Sixth Circuit. Or it might apply to accounts in which the customer's address is in the Sixth Circuit. Or it might apply to transactions that occur in the Sixth Circuit. But in each of those cases, an argument could be made by a litigant after



the fact that Regulation Z applied instead. For example, a lender in Ohio that makes the Sixth Circuit disclosures to all of its customers cannot be assured that a customer from New York will not demand Regulation Z disclosures rather than Sixth Circuit disclosures. A lender in Delaware that makes Regulation Z disclosures to a customer with a Florida address cannot be sure that the customer did not make his or her over-limit transaction in Ohio, and would not, on that basis, demand Sixth Circuit disclosures. Even when a lender and borrower are both within the Sixth Circuit, the lender cannot be sure that making the Sixth Circuit disclosures will insulate it from liability. The customer may have engaged in a transaction in another circuit, or may simply be included in a nationwide class action begun outside the Sixth Circuit claiming a violation of Regulation Z.

Moreover, lenders will face significant liability if a court ultimately determines that they have applied the wrong rule. As explained above, in addition to actual damages, lenders who violate TILA or Regulation Z are subject to statutory damages of twice the finance charge for the transaction (up to the lesser of $500 thousand or 1% of the creditor's net worth in the case of class actions), the costs of the action, and attorneys' fees. 15 U.S.C. 1640(a). Lenders could not avoid liability by following the Sixth Circuit rule in all situations and asserting TILA's "good faith" defense, because that provision provides immunity from liability based on compliance with rules and interpretations of the Board or its staff, not judicial interpretations. 15 U.S.C. 1640(f). And, if the Sixth Circuit's ruling in this case becomes final, lenders could no longer avoid liability in circumstances where that ruling is deemed to apply by claiming "good faith" reliance on Regulation Z. The dilemma that this situation presents to card issuers is in many ways more troubling than a typical circuit

split, where the parties at least know which rule applies in a particular jurisdiction.[3]

Lenders confront the risks posed by the conflicting disclosure rules on OCL fees on a daily basis. There are almost 1.3 billion credit card accounts in the United States. See Thompson Financial Media, *Card Industry Directory* 16 (2003). Each time an OCL fee is imposed on one of those accounts, the fee must be disclosed on the monthly statement. And each time a credit card issuer makes one of those disclosures, the dual disclosure regime created by the Sixth Circuit exposes the lender to potential liability.

The existence of conflicting disclosure rules also frustrates TILA's goal of enabling consumers accurately to compare the cost of credit. See 15 U.S.C. 1601(a). Uniformity of disclosure rules is critical to the "meaningful disclosure" that Congress sought to achieve by enacting TILA. 15 U.S.C. 1601(a). If consumers receive different disclosures based on where lenders are located or where particular transactions take place, consumers cannot accurately compare the costs of obtaining credit from different lenders. Thus, TILA's effectiveness will be significantly impaired if this Court declines review and allows the divergent disclosure regimes created by the Sixth Circuit rule to stand.

2. Even apart from creating a conflict in applicable disclosure rules, the Sixth Circuit's rule imposes significant burdens on creditors and is likely to cause confusion among consumers. Compliance with the rule would require creditors to modify their practices and their systems to find a way to capture information that would allow them to determine

[3] Federal banking agencies and other regulators with administrative enforcement authority over violations of TILA, see 15 U.S.C. 1607(a), will be faced with similar problems, with different regional offices required to apply different standards to review compliance by banks and other lenders operating throughout the country.



whether they "knowingly" permitted the particular extension of credit that put a cardholder over his or her credit limit. As detailed above, the point-of-sale authorization system is not currently capable of providing that information accurately, and development of a system that could make such distinctions would be costly and burdensome. Further, as explained above, consumers are likely to be confused, not informed, by a system that identifies some OCL fees as finance charges and some as other charges, when, from the consumer's perspective, the fees result from the same action.

Moreover, the Sixth Circuit's ruling impairs the orderly administration of TILA. More than 20 years ago, this Court noted Congress's "preference for resolving interpretive issues [under TILA] by uniform administrative decision, rather than piecemeal through litigation," because administrative rulemaking more readily produces the "coherent and predictable body of technical rules" demanded by that complex statute. *Milhollin*, 444 U.S. at 568 & n.12. The Court admonished lower courts to "honor that congressional choice" and "refrain from substituting their own interstitial lawmaking for that of the [Board], so long as the latter's lawmaking is not irrational." *Id.* at 568. The Sixth Circuit's decision disregards that admonition and threatens a return to an era when courts routinely issue interpretations of TILA that conflict with those of the Board. Both Congress and this Court have made clear that such judicial rulemaking is antithetical to this statutory scheme.[4]

[4] Further proceedings in the district court on remand would not eliminate the adverse effects of the Sixth Circuit's decision. The decision imposes a new and incorrect legal test for the disclosure of OCL fees that depends on the subjective state of mind of the card issuer when authorizing a proposed charge. Additional development of the factual situations in which a creditor "knowingly" agrees to extend additional credit, or further elucidation of the legal criteria for determining a "knowing"

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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MAY 2003

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authorization and approval, even if permissible under the court of appeals' opinion, will not eliminate the fundamental defects of the court's holding.

No. 02-857

IN THE

# Supreme Court of the United States

HOUSEHOLD CREDIT SERVICES, INC.
AND MBNA AMERICA BANK, N.A.,
*Petitioners*,

*v.*

SHARON R. PFENNIG,
*Respondent.*

**On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit**

## BRIEF FOR PETITIONER


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## QUESTION PRESENTED

Whether the Sixth Circuit improperly substituted its interpretation of the Truth in Lending Act for that of the Federal Reserve Board—the agency entrusted by Congress with responsibility for interpreting the statute—in invalidating an important provision of Regulation Z that excludes fees imposed "for exceeding a credit limit" (12 C.F.R. § 226.4(c)(2)) from the definition of "finance charge" (15 U.S.C. § 1604(a)).

## LIST OF PARTIES AND RULE 29.6 STATEMENT

The caption of the case contains the names of all the parties to the proceedings before the court of appeals.

The parent company of petitioner Household Credit Services, Inc. is Household Finance Corporation, which is a wholly owned subsidiary of Household International, Inc. Household International, Inc., in turn, is a wholly owned subsidiary of HSBC Holdings plc.

The parent company of petitioner MBNA America Bank, N.A. is MBNA Corporation. Alliance Capital Management L.P. ("Alliance") and certain affiliates of Alliance (together with their parent corporations AXA Financial, Inc., AXA, and certain AXA affiliates) beneficially own more than 10% of MBNA Corporation's common stock.

No other publicly held company owns 10% or more of the stock of either petitioner.

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IN THE

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HOUSEHOLD CREDIT SERVICES, INC.,
AND MBNA AMERICA, N.A.,
*Petitioners*,

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SHARON R. PFENNIG,
*Respondent*.

**On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit**

## BRIEF FOR PETITIONER

### OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A23) is reported at 295 F.3d 522 (6th Cir. 2002). The opinion of the district court (Pet. App. A24-A29) is unreported.

### JURISDICTION

The judgment of the court of appeals was entered on July 2, 2002, and a timely petition for rehearing was denied on September 3, 2002. The petition for a writ of certiorari was filed on December 2, 2002, and was granted on June 27, 2003. This Court has jurisdiction under 28 U.S.C. § 1254(1).

### STATUTES AND REGULATIONS INVOLVED

This case involves the following provisions of the Truth in Lending Act:

§ 1604. Disclosure guidelines

(a) *Promulgation, contents, etc., of regulations*

The Board shall prescribe regulations to carry out the purposes of this subchapter. Except in the case of a mortgage referred to in section 1602(aa) of this title, these regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this subchapter, to prevent circumvention or evasion thereof, or to facilitate compliance therewith.

15 U.S.C. § 1604(a).

§ 1605. Determination of finance charge

(a) *"Finance charge" defined*

Except as otherwise provided in this section, the amount of the finance charge in connection with any consumer credit transaction shall be determined as the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit.

15 U.S.C. § 1605(a).

Another section of the Truth in Lending Act, 15 U.S.C. § 1637, is reproduced in an Appendix to this brief.

This case also involves the following regulation issued by the Federal Reserve Board:

§ 226.4. Finance charge.

* * * *

(c) *Charges excluded from the finance charge.* The following charges are not finance charges:

* * * *

(2) Charges for actual unanticipated late payment, for exceeding a credit limit, or for delinquency, default, or a similar occurrence.



12 C.F.R. § 226.4(c)(2).

## STATEMENT

A divided panel of the United States Court of Appeals for the Sixth Circuit invalidated an important, previously unquestioned, regulation issued in 1981 by the Board of Governors of the Federal Reserve System ("Board"). Under the regulation, when a creditor imposes a fee on a consumer for exceeding the credit limit, the fee should be disclosed, not as part of the "finance charge," but, rather, as an "other charge." In enacting the Truth in Lending Act ("TILA"), 15 U.S.C. § 1601 *et seq.*, Congress delegated expansive authority to the Board to interpret the statute and issue such regulations. Under this Court's precedents, the Board's regulations implementing TILA are valid unless demonstrably irrational. *See Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 565 (1980). Contrary to the high level of deference due, the court of appeals disregarded the Board's expertise, substituted its own interpretation of TILA, and held that the Board's regulation excluding over-limit fees from the finance charge "cannot stand." Pet. App. A12. The court's decision invalidating the Board's regulation is incorrect and should be reversed.

### A. TILA And Regulation Z

*1. Statutory background.* Congress enacted TILA in 1968 "to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit . . . ." 15 U.S.C. § 1601(a). TILA is a disclosure statute, not a restriction on the amounts that creditors may charge; it "provides for full disclosure of credit charges, rather than regulation of the terms and conditions under which credit may be extended." H.R. Rep. No. 90-1040 (1967), *reprinted in* 1968 U.S.C.C.A.N. 1962, 1963. Congress determined that "such full disclosure would aid the consumer in deciding for himself the reasonableness of the credit charges imposed and further permit the consumer to 'comparison shop' for credit," thus "encourag[ing] a wiser and more judicious use of consumer credit." *Id.*

Neither state nor federal law requires that creditors follow a single model in framing the terms of their consumer credit offerings. Congress recognized that, as a result of the ensuing "complexity and variety, . . . credit transactions defy exhaustive regulation by a single statute." *Milhollin*, 444 U.S. at 559. Accordingly, "[t]o accomplish its desired objective, Congress determined to lay the structure of [TILA] broadly and to entrust its construction to an agency with the necessary experience and resources to monitor its operation." *Mourning* v. *Family Publ'ns Serv., Inc.*, 411 U.S. 356, 365 (1973). Congress directed the Board to "prescribe regulations to carry out the [statute's] purposes." 15 U.S.C. § 1604(a). TILA provides that "these regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate [TILA's] purposes . . . or to facilitate compliance therewith." *Id.* Pursuant to that delegation of authority, the Board promulgated a regulation, known as Regulation Z, that implements TILA. *See* 12 C.F.R. Part 226.

In 1980, Congress amended TILA through the Truth in Lending Simplification and Reform Act ("Simplification Act"), Pub. L. No. 96-221, Title VI, 94 Stat. 132, 180. Despite the success of the original TILA, Congress determined that "the interests of both consumers and creditors would be furthered by simplification and reform of the act." S. Rep. No. 96-73, at 2 (1979), *reprinted in* 1980 U.S.C.C.A.N. 280, 281. Congress found that "disclosure forms given to consumers" often were "too lengthy and difficult to understand." *Id.* In addition, creditors "encountered increasing difficulty in keeping current with a steady stream of administrative interpretations and amendments, as well as highly technical judicial decisions." *Id.* Many creditors who "sincerely tried to comply with the act" nonetheless "found themselves in violation and subject to litigation" due to the statute's "increasing complexity and frequent changes." *Id.* Congress thus amended TILA "to provide the consumer with clearer credit information" and to



"make creditor compliance easier." *Id.*, 1980 U.S.C.C.A.N. at 280.

*2. TILA's disclosure regime.* Under TILA, credit card issuers ordinarily must disclose significant charges imposed as part of a credit plan either in the "finance charge" or as "other charges." TILA requires creditors to make such disclosures on three principal occasions: (i) in certain applications and solicitations, (ii) in initial disclosures before a credit plan is opened, and (iii) in periodic billing statements. *See* 15 U.S.C. § 1637. With regard to applications and solicitations, creditors must disclose, *inter alia*, the "annual percentage rate applicable to extensions of credit under such credit plan,"[1] as well as certain other charges that may be imposed, including "late fee[s]" and "[o]ver-the-limit fee[s]."[2] *Id.* § 1637(c)(1). With regard to initial disclosures, creditors must disclose, *inter alia*, the "conditions under which a finance charge may be imposed," the "method of determining the amount of the finance charge," the "periodic rates [that] may be used to compute the finance charge," and "other charges which may be imposed as part of the plan." *Id.* § 1637(a). Finally, with regard to periodic billing statements, creditors must disclose, *inter alia*, the "amount of any finance charge added to the account during the period," the "periodic rates [that] may be used to compute the finance charge," and, ordinarily, "the total finance charge expressed as an annual percentage rate." *Id.* § 1637(b).

TILA generally defines a "finance charge" as "the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or

---

[1] The annual percentage rate is "the quotient (expressed as a percentage) of the total finance charge for the period to which it relates divided by the amount upon which the finance charge for that period is based, multiplied by the number of such periods in a year." 15 U.S.C. § 1606(a)(2).

[2] TILA requires that over-limit fees and late fees be disclosed "clearly and conspicuously" in applications and solicitations. 15 U.S.C. § 1637(c)(1)(B), (c)(4)(B).

indirectly by the creditor as an incident to the extension of credit." *Id.* § 1605(a). TILA provides examples of specific charges that must be included in the finance charge and other charges that may or must be excluded. *See id.* § 1605. TILA is silent on the precise question whether over-limit fees are to be included in the finance charge.

TILA subjects "any creditor who fails to comply with [its] requirement[s]" to civil liability for actual damages, statutory damages and reasonable attorney's fees and costs. 15 U.S.C. § 1640(a). The statute provides, however, that creditors who act "in good faith conformity with any rule, regulation, or interpretation thereof by the Board" are immune from civil liability, even if the rule, regulation or interpretation is later "amended, rescinded, or determined by judicial or other authority to be invalid for any reason." *Id.* § 1640(f).

*3. The relevant provision of Regulation Z.* In Regulation Z, the Board implemented TILA's general definition of "finance charge" by providing creditors with definitive examples of charges that should, and should not, be included. *See* 12 C.F.R. § 226.4.

Ever since TILA's enactment, there has been an important need for the Board's guidance regarding which specific fees and charges should be included in, and excluded from, the "finance charge." The Board explained the need for such definitive rules interpreting the term "finance charge" in a 1996 report requested by Congress:

> The finance charge does not include every cost associated with obtaining consumer credit, such as many charges paid in a real estate-secured loan. From the beginning of the discussion about the concept of "Truth in Lending" in the 1960s there has been considerable debate about which costs should be classified as finance charges for disclosure purposes. Over the years, a complex set of rules has attempted to define with precision which charges should or should not be considered finance charges. Despite these rules, ambiguities have persisted, and in recent years lenders have become increasingly concerned about litigation alleging incorrect categorization of these charges.



Board of the Governors of the Federal Reserve System, *Report to the Congress: Finance Charges for Consumer Credit Under the Truth in Lending Act* 1 (Apr. 1996).

In the original version of Regulation Z, § 226.4(c) excluded from the finance charge certain fees imposed in connection with a breach of the credit agreement by the consumer, such as charges for "late payment, delinquency, default, reinstatement, or other such occurrence." 34 Fed. Reg. 2002, 2004 (Feb. 11, 1969). Although the original regulation did not expressly address over-limit fees, the Board and its staff nevertheless interpreted the regulation as excluding such fees from the finance charge on the ground that over-limit fees were a type of delinquency or default charge. *See* Official Interpretive Letter FC-0142 (Fed. Reserve Bd. Jan. 9, 1978); Unofficial Staff Interpretation PI-1281 (Fed. Reserve Bd. Feb. 14, 1978).

Following enactment of the Simplification Act in 1980, the Board amended Regulation Z to provide creditors "with clearer, more understandable, and less burdensome rules." 45 Fed. Reg. 29702, 29702 (May 5, 1980). The Board specifically proposed to add to § 226.4(c) an express reference to over-limit fees, making clear that such fees should be excluded from the finance charge. *See id.* at 29735. The proposed revisions were exposed to two rounds of public comments. These "comments reflected strong support for the concept of simplification." 45 Fed. Reg. 80648, 80648 (Dec. 5, 1980). The Board stressed that its proposed revisions "substitute[], where possible, precise, easily-applied rules for principles that create ambiguity and require additional regulatory clarification." *Id.* In 1981, the Board issued a final rule incorporating its extensive revisions of Regulation Z. *See* 46 Fed. Reg. 20848 (Apr. 7, 1981). That final rule included the current language of 12 C.F.R. § 226.4(c)(2), a bright-line rule "exclud[ing] from the finance charge ... [c]harges for actual unanticipated late payment,

*for exceeding a credit limit*, or for delinquency, default, or a similar occurrence." 46 Fed. Reg. at 20894 (emphasis added).

Since the 1981 revision, the Board has amended Regulation Z approximately 20 times in response to statutory amendments, changes in banking practices, or other pertinent developments. *See, e.g.*, 66 Fed. Reg. 65604 (Dec. 20, 2001). For example, in 1989, the Board first amended Regulation Z to implement an amendment to TILA requiring disclosures in table format for certain applications and solicitations (the so-called "Schumer Box"). *See* 54 Fed. Reg. 13855 (Apr. 6, 1989) (implementing Fair Credit and Charge Card Disclosure Act of 1988, Pub. L. No. 100-583, 102 Stat. 2960). These Schumer Box regulations included new disclosure requirements for credit card over-limit fees. The Board has not at any time changed, or proposed to change, the § 226.4(c)(2) exclusion of over-limit fees from the definition of "finance charge."

Regulation Z today requires disclosures in (i) applications and solicitations, (ii) initial disclosures before a credit plan is opened, and (iii) periodic billing statements. *See* 12 C.F.R. §§ 226.5a, 226.6, 226.7. In each instance, Regulation Z requires creditors to disclose over-limit fees separately from the finance charge. *See id.* §§ 226.5a(b)(10) (applications and solicitations), 226.6(b) (initial disclosures), 226.7(h) (periodic statement); *see also id.* pt. 226, Supp. I (commentary to §§ 226.6(b), 226.7(h)).

## B. Proceedings In The District Court

*1. Respondent's complaint.* Respondent Sharon Pfennig is a consumer who holds a credit card originally issued by an affiliate of petitioner Household Credit Services, Inc. and later acquired by petitioner MBNA America Bank, N.A. *See* Pet. App. A31-A32. Petitioners charged respondent an over-limit fee of $29 during certain months in which her balance exceeded the $2,000 credit limit applicable to her account. *See id.* at A33, A39. In accordance with Regulation Z, petitioners did not include this fee in the finance charge on respondent's periodic billing statement,



but did disclose the fee separately as an "other charge." *See id.* at A33, A39-A40.

In August 1999 respondent filed this action in the United States District Court for the Southern District of Ohio on behalf of a purported nationwide class of petitioners' cardholders. *See id.* at A33-A36. Her complaint alleged that petitioners "allowed [her] to make charges" that caused her to exceed her credit limit and then imposed an "over limit fee" for every month that her balance exceeded that limit. *Id.* at A39.[3] Without acknowledging the provision of Regulation Z that governed petitioners' disclosures of the over-limit fee—under which petitioners' disclosures were proper—respondent alleged that petitioners violated TILA by omitting the fee "from the finance charge calculation" on her periodic billing statement. *Id.* at A33. Respondent sought declaratory and injunctive relief as well as monetary damages. *See id.* at A40-A41.

*2. The district court decision.* Relying on Regulation Z's express exclusion of over-limit fees from the finance charge, petitioners moved to dismiss the complaint for failure to state a claim upon which relief can be granted. The district court granted petitioners' motion, holding that "in light of the plain language of Regulation Z, the 'over-limit fee' at issue in this case is not a finance charge" under TILA. *Id.* at A27.

The district court recognized that it must "give deference to the Federal Reserve Board's statutory interpretation of the term finance charge." *Id.* at A28. Applying the standard set forth by this Court in *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 565 (1980), the court concluded that "Regulation Z's exclusion of the 'over limit fee' from the definition of 'finance charge' is rationally based." Pet. App. A28. The court explained:

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[3] These allegations are accepted as true because this case comes to the Court on petitioners' motion to dismiss the complaint pursuant to Federal Rule of Civil Procedure 12(b)(6).

> Section 226.4(c)(2) excludes several categories of charges, all of which arise when the terms under which the credit was extended have been breached by the borrower. These categories include the making of unanticipated late payments or the exceeding of a credit limit. Further included in these categories are charges arising after delinquency or default. Each of these categories include charges for past credit extension events that were not agreed to by the parties. The lender agreed to loan and the borrower agreed to borrow under agreed upon terms which were "incident to the extension of credit," as that term is used in 15 U.S.C. § 1605(a). No such agreement was reached permitting unanticipated late payments, delinquency, or default. No such agreement was reached as to the borrower unilaterally exceeding the agreed upon credit limit. All of these post-credit extension occurrences are done in violation of the agreed upon terms upon which the credit was extended. Such charges are never imposed upon a borrower who simply follows the terms of the agreement. The Federal Reserve Board rationally determined that these charges, for acts amounting to breaches of the agreed upon credit extension, are not finance charges.

*Id.*

### C. The Court Of Appeals Decision

A divided panel of the Sixth Circuit reversed in part and affirmed in part. The panel majority held that Regulation Z's exclusion of over-limit fees from the finance charge is invalid because it conflicts with TILA's general definition of finance charge. The court concluded, however, that petitioners are immune from monetary damages under TILA because they complied in good faith with Regulation Z.

*1. The majority opinion.* The Sixth Circuit conceded that "the fee at issue in this case was imposed for 'exceeding



a credit limit'" and that "Regulation Z expressly states that charges imposed for exceeding credit limits are excluded from the 'finance charge.'" Pet. App. A17. The court also acknowledged its obligation under this Court's decisions to give "deference . . . to the [Board's] interpretation of the Act as long as such interpretations are not irrational." *Id.* at A6. The Sixth Circuit nonetheless refused to defer to the Board's interpretation of TILA for two principal reasons.

First, the court of appeals stressed "that TILA, as a remedial statute, must be given a liberal interpretation in favor of consumers in order to protect them in credit transactions." *Id.* at A8-A9. Declining to acquiesce in the Board's expertise and judgment, the court concluded that "TILA's statutory goal of providing adequate disclosure in order that the consumer will knowledgeably be able to compare credit options" would best be served by including over-limit fees in the finance charge. *Id.* at A12.

Second, the court of appeals held that, applying a liberal interpretation, the over-limit fee imposed in this case necessarily falls "within the statutory definition of finance charge." *Id.* at A9. The court noted that "TILA defines a finance charge as the sum of 'all charges' paid by the person to whom credit is extended and assessed by the creditor 'as an incident to the extension of credit.'" *Id.* (emphasis omitted) (quoting 15 U.S.C. § 1605(a)). Based on respondent's allegation that petitioners "allowed" her to exceed her credit limit by accepting the charge that put her over the limit, the court concluded that the over-limit fee in this case was imposed "as incident to th[e] extension of credit" and thus was a finance charge under TILA. *Id.* at A13.

For these reasons, the court ruled that "Regulation Z's exclusion of over-limit fees . . . from the 'finance charge' conflicts with the express language of TILA" and that "the regulation [therefore] cannot stand." *Id.* at A12. Having rejected the Board's classification of over-limit fees, the court of appeals substituted a fact-dependent test of its own making. Under the Sixth Circuit's new test, an over-limit fee must be included in the finance charge if "the creditor *knowingly permits the credit card holder to exceed his or her*

*credit limit and then imposes a fee incident to the extension of that credit.*" *Id.* at A15 n.5 (emphasis added).

The court of appeals nevertheless affirmed the dismissal of respondent's claim for damages, holding that "it is beyond cavil that [petitioners] complied with Regulation Z and pursuant to 15 U.S.C. § 1640(f) should be afforded immunity from civil damages." Pet. App. A18 n.6. As the court explained, "it is undisputed that the fee at issue in this case was imposed for 'exceeding a credit limit.'" *Id.* at A17. Based on these "undisputed facts," the court concluded that petitioners "are entitled to immunity from civil liability for failing to disclose [the fee] as part of the finance charge." *Id.* at A18.

*2. The dissent.* Chief Judge Edgar of the United States District Court for the Eastern District of Tennessee, sitting by designation, dissented. Observing that "[o]ver-limit fees are nowhere mentioned" in "the general statutory definition of finance charge," Pet. App. A20, Judge Edgar disagreed with the majority's conclusion that Regulation Z conflicts with TILA.

First and foremost, Judge Edgar explained, the majority had improperly substituted its own interpretation of TILA for that of the Board (*id.* at A22.):

> The majority's interpretation of § 1605(a) might well be a reasonable one; but so is that of the Federal Reserve Board. Certainly it cannot be said that the Federal Reserve's exclusion of over-limit charges from the finance charge in Regulation Z is demonstrably irrational. The Federal Reserve merely filled in a blank left by Congress in the TILA, and analogized over-limit charges to unanticipated late payments and charges for delinquency or default. These other charges are clearly not a part of the finance charge because they are, as the district court concluded, post extension of credit occurrences. The same can be reasonably said about over-limit fees.



Judge Edgar was also skeptical of the majority's assumptions about the operation of the credit card industry. He noted that

> [t]he majority's rationale is that an over-limit fee is "imposed incident to the extension of credit" because after [respondent] reached her credit limit, she in effect requested more credit by exceeding the limit; and by permitting her to exceed the limit and charging her a fee, [petitioners] imposed the fee "incident to the extension of credit."

*Id.* at A20-A21. As Judge Edgar observed, respondent's assertion "that a credit card issuer 'gets to make the decision as to whether or not [an over-limit] charge will be permitted to go through' may not, in all cases, be accurate." *Id.* at A21 (alteration in original). He explained: "From our personal experience we know that many merchants check credit cards on-line before accepting customer charges. However, this may not be true in all cases; and, of course, the TILA and Regulation Z apply to all consumer credit transactions, not just those of [respondent]." *Id.*

Finally, Judge Edgar criticized the majority for replacing Regulation Z's bright-line classification with a case-specific test that would lead to "lack of uniformity and confusion." *Id.* at A23 n.1. The majority's decision, he explained, "means that credit card issuers must only disclose an over-limit fee when they have been made aware that an over-limit charge is pending approval, and they then permit the charge to go through." *Id.* Under this test, "some card issuers may be required to disclose under some circumstances, while others may not." *Id.*

*3. The request for rehearing.* Petitioners sought panel rehearing and rehearing en banc. The Board, which learned of the case only after the court of appeals had issued its initial decision, filed an amicus brief that sought to explain its regulation. *See* Pet. App. A43-A53. The Board explained that its "rule excluding over-limit fees from the finance charge is based on the rational assumption that the fees are imposed when the consumer uses the credit plan in a manner

that violates the terms of the plan." *Id.* at A46. "Based on the rule, consumers can use uniform disclosures to compare the cost of credit card programs offered by different creditors that do not account for contingent costs that may be imposed under each plan for unanticipated events such as late payments or over-limit situations." *Id.*

In light of the Sixth Circuit's reliance on self-generated assumptions about standard credit card authorization processes, the Board also attempted to advise the court about credit industry practices that inform the regulation. The Board explained that the panel majority had erred by assuming that if a creditor processes a charge that results in an account exceeding its credit limit, then the creditor has in effect renegotiated the terms of the parties' credit agreement and knowingly agreed to extend additional credit to the cardholder in return for the price of the over-limit fee. *See id.* at A47-A48. Contrary to the court's assumption, the Board explained, standard credit card "authorization" systems do not provide creditors the ability to determine whether a particular charge will cause an account to exceed its credit limit:[4]

> First, credits to the consumer's account are not posted until the end of the day. Thus, for example, a transaction that appears to push the account balance over the credit limit at 4:00 p.m. may turn out to have no such effect when a payment reducing the account balance is posted later that day. Second, in many cases, instead of seeking

[4] These so-called "authorization" systems are arrangements between merchants and credit card companies, who "authorize" the merchant to submit a credit card charge to the credit card system for payment. With certain exceptions, if a merchant properly seeks and receives "authorization" for a charge, the credit card issuer may not subsequently refuse to pay the charge. The consumer is not a party to the "authorization." *See, e.g., United States* v. *Visa U.S.A. Inc.*, 163 F. Supp. 2d 322, 332 n.4 (S.D.N.Y.) (describing typical form of transaction in Visa and MasterCard systems), *judgment modified*, 183 F. Supp. 2d 613 (S.D.N.Y. 2001), *stay granted*, 2002 WL 638537 (S.D.N.Y. Feb. 7, 2002).



> authorization for the actual transaction amount, a merchant will send in a request for a nominal amount simply in order to determine whether the consumer has a "live" card. In such a case, the actual transaction may cause the account balance to exceed the credit limit even though the authorization request gave the issuer no notice of that possibility. Third, in some cases, such as hotel or car rental charges, merchants can "block" large amounts of credit on check-in to ensure that the charge will be authorized when the consumer checks out and pays, making an account look substantially closer to its credit limit than it in fact is.

*Id.* at A49-A50 (footnotes omitted). These and other uncertainties make it impossible for creditors to have precise, real-time knowledge that a particular charge will cause an account to exceed its credit limit.

As the Board further explained in its brief, "creditors generally do not deny authorization on the mere suspicion that a transaction would cause the account balance to exceed the consumer's credit limit." *Id.* at A50. Instead, creditors

> typically determine whether to impose [an over-limit] fee only at the end of the billing cycle, when it can be determined that all charges and credits to the account establish that the consumer is in fact over the credit limit, and when other factors, such as the consumer's payment history, the amount by which the limit is exceeded, and whether the limit has been exceeded in the past, for example, may be taken into account.

*Id.* For this reason, over-limit fees commonly are not imposed in connection with a specific charge but, instead, as a result of multiple factors related to the account's overall status. *See id.* at A50-A51.

In the Board's view, these credit card practices demonstrated that "authorization" of a charge that ultimately results in an account exceeding its credit limit does not signal the creditor's consent to the cardholder's

incurring debt beyond the credit limit. *See id.* at A50. On the contrary, creditors oppose such behavior and impose over-limit fees "to impose discipline on consumer credit usage." *Id.*; *see also id.* at A51 (noting that over-limit fees are "imposed to affect consumer behavior to comply with the requirements of a credit agreement"). Given these realities, the Board explained that its regulation rationally treats "the over-limit fee [similarly] to other charges—such as late fees—that are not finance charges because they are not incident to a particular extension of credit." *Id.* at A51. Instead, over-limit fees are imposed because the customer's incurring of debt exceeding the credit limit is an "act[] of default under the credit contract." *Id.* at A45.

The Sixth Circuit denied panel rehearing, but amended its opinion to add a footnote rejecting the Board's arguments. The court dismissed the Board's explanation of the reasons for its regulation and "the actual operation of the credit card industry" as facts that "were never raised below and are not in the record." *Id.* at A10 n.2. The full court later denied petitioners' request for rehearing en banc. *Id.* at A30.

## SUMMARY OF ARGUMENT

The Sixth Circuit erroneously invalidated an important provision of Regulation Z that had been in effect for over two decades.

TILA does not address the precise question of whether over-limit fees should be included in the "finance charge" or disclosed separately as "other charges." In 1981, the Board filled this gap by amending Regulation Z to make clear that over-limit fees should not be included in the finance charge. This clear and easily applied rule furthered the goal of the Truth in Lending Simplification and Reform Act of 1980, which was to provide clearer credit information to consumers and make compliance easier for creditors.

TILA gives the Board unusually broad authority to make "such classifications ... as in the judgment of the Board are necessary or proper to effectuate the purposes of



[TILA]." 15 U.S.C. § 1604(a). In view of this expansive delegation of power, this Court has held that the Board's interpretations of TILA are "dispositive" unless "demonstrably irrational." *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 565 (1980). Thus, "absent some obvious repugnance to the statute, the Board's regulation implementing [TILA] should be accepted by the courts." *Anderson Bros. Ford* v. *Valencia*, 452 U.S. 205, 219 (1981). It cannot be said that the Board's regulation excluding over-limit fees from the finance charge is demonstrably irrational or obviously repugnant to TILA. The Board instead reasonably classified over-limit fees—like other fees imposed because a consumer violates the credit agreement—as other charges that must be disclosed separately.

Although it cited *Milhollin* and *Valencia*, the Sixth Circuit failed to accord the Board's regulation the broad deference that those cases require. To the contrary, the court of appeals rejected the Board's reasonable interpretation of TILA, substituting instead what the court believed to be "a liberal interpretation in favor of consumers." Pet. App. A8. In attempting to determine on its own which rule would best "protect [consumers] in credit transactions," *id.* at A8-A9, the Sixth Circuit improperly usurped the role that Congress assigned to the Board. Rather than interpret TILA's general language liberally, the court of appeals was required to defer to the Board's rational interpretation of the statute, as well as to the Board's expert judgment that consumers are better able to compare the costs of credit if over-limit fees are not included in the finance charge.

In holding that the over-limit fee in this case was imposed "as an incident to th[e] extension of credit," the Sixth Circuit also mistakenly assumed that by authorizing a transaction that causes an account to exceed the credit limit, a creditor in effect "renegotiate[s] the [credit] agreement." *Id.* at A13. As the Board explained, its regulation is rationally based on its knowledge of actual authorization processes used in the credit card industry. These point-of-sale authorization systems are not designed to, and general-

ly do not, enable creditors to determine whether a transaction will cause the consumer to go over the credit limit and incur an over-limit fee. *See id.* at A50. That the Sixth Circuit invalidated a long-standing regulation based on a misunderstanding of the actual operation of the credit card industry shows why courts should defer to the Board's views and not attempt to chart their own course to TILA's purposes.

## ARGUMENT

### I. The Federal Reserve Board Has The Power To Promulgate Regulations Rationally Interpreting The Truth In Lending Act.

As a general matter, a court considering the validity of an agency regulation interpreting a statute must undertake a two-step inquiry. If "Congress has directly spoken to the precise question at issue[,] ... the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Chevron U.S.A. Inc.* v. *Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-43 (1984). However, "if the statute is silent or ambiguous with respect to the specific issue," and the agency regulation "is based on a permissible construction of the statute," the court must defer to that regulation. *Id.* at 843. "The court need not conclude that the agency construction was the only one it permissibly could have adopted ..., or even the reading the court would have reached if the question initially had arisen in a judicial proceeding." *Id.* at 843 n.11. Rather, so long as the agency's construction of the statute is reasonable, the court must defer to the agency and "may not substitute its own construction of [the] statutory provision." *Id.* at 844. Here, the Board acted in the manner that commands the highest level of deference: formal notice-and-comment rulemaking. *See United States* v. *Mead Corp.*, 533 U.S. 218, 229-30 (2001).

In the TILA context, the Board's regulations are entitled to even greater deference than might be due under general administrative-law principles. Congress envisioned a special role for the Board in the implementation of TILA when it instructed the Board to "prescribe regulations to



carry out the purposes" of the statute. 15 U.S.C. § 1604(a). Congress authorized the Board broadly to promulgate regulations that contain "classifications, differentiations, or other provisions, ... adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of [TILA], to prevent circumvention or evasion thereof, or to facilitate compliance therewith." *Id.* In light of this expansive delegation of authority, as well as the Board's particular expertise in the technical and complex area of credit-related disclosures covered by TILA, this Court has held that, "absent some *obvious repugnance* to the statute, the Board's regulation[s] implementing [TILA] should be accepted by the courts." *Anderson Bros. Ford* v. *Valencia*, 452 U.S. 205, 219 (1981) (emphasis added).

The Court has emphasized the "high degree of deference" due the Board, holding in *Ford Motor Credit Co.* v. *Milhollin* that the Board's interpretations of TILA are "dispositive" unless "demonstrably irrational." 444 U.S. 555, 557, 565 (1980). While principles of administrative law require courts as a general matter to be "attentive[] to the views of the administrative entity appointed to apply and enforce a statute," the Court stated that such "deference is especially appropriate in the process of interpreting the Truth in Lending Act." *Id.* at 565. "Because of their complexity and variety, ... credit transactions defy exhaustive regulation by a single statute. Congress therefore delegated expansive authority to the Federal Reserve Board to elaborate and expand the legal framework governing commerce in credit." *Id.* at 559-60.

In *Milhollin*, the Court identified several reasons why the Board's interpretations of TILA are entitled to a special level of deference. First, "acquiescence in administrative expertise is particularly apt under TILA because the Federal Reserve Board has played a pivotal role in setting [the statutory] machinery in motion." *Id.* at 566 (internal quotation omitted) (second alteration in original). The Court emphasized that "Congress delegated broad administrative lawmaking power to the Federal Reserve Board when it

framed TILA" and that "[t]he Act is best construed by those who gave it substance in promulgating regulations thereunder." *Id.*[5]

Second, the Court pointed to clear evidence of Congress's intent to vest broad policymaking power in the Board: "Congress has specifically designated the Federal Reserve Board and staff as the primary source for interpretation and application of truth-in-lending law. Because creditors need sure guidance through the 'highly technical' Truth in Lending Act, legislators have . . . acted to promote reliance upon Federal Reserve pronouncements." *Id.* (citation omitted). The Court noted that TILA's grant of immunity from damages for good-faith reliance on the Board's interpretations "signals an unmistakable congressional decision to treat administrative rulemaking and interpretation under TILA as authoritative." *Id.* at 567-68. "Moreover, language in the legislative history evinces a decided preference for resolving interpretive issues by uniform administrative decision, rather than piecemeal through litigation." *Id.* at 568. The Court emphasized that judges "should honor that congressional choice" and "refrain from substituting their own interstitial lawmaking for that of the Federal Reserve, so long as the latter's lawmaking is not irrational." *Id.*

Third, the Court concluded that broad "deference to the Federal Reserve is compelled by necessity; a court that tries to chart a true course to the Act's purpose embarks upon a voyage without a compass when it disregards the agency's views." *Id.* Fulfillment of TILA's goal of "meaningful disclosure" requires "striking the appropriate balance"

[5] *Milhollin* involved Board staff opinions interpreting TILA and Regulation Z. The degree of deference due to provisions of Regulation Z itself, promulgated after notice and public comments pursuant to the Administrative Procedure Act and delegation by Congress of "broad administrative lawmaking power" is at least as great. *See Mead Corp.*, 533 U.S. at 229-30; *Christensen* v. *Harris County*, 529 U.S. 576, 587-88 (2000).



between "complete disclosure" and "informational overload," an "empirical process that entails investigation into consumer psychology and that presupposes broad experience with credit practices." *Id.* at 568-69 (internal quotation marks and citation omitted). As the Court recognized, "[a]dministrative agencies are simply better suited than courts to engage in such a process." *Id.* at 569.[6]

## II. The Truth In Lending Act Is Ambiguous Regarding Whether Over-Limit Fees Must Be Included In The Finance Charge.

The dispute in this case is not whether creditors must disclose over-limit fees to consumers. Creditors must disclose those fees, and it is undisputed that petitioners did so. The issue here is whether creditors must identify such over-limit fees as part of the "finance charge" or, instead, as "other charges." TILA is silent on that precise question.

TILA defines the term "finance charge" as "the sum of all charges" imposed by the creditor "as an incident to the extension of credit." 15 U.S.C. § 1605(a). This is a general, not a precise, definition. Congress recognized this imprecision and, accordingly, followed the definition with several illustrative examples of charges included in the finance charge. *See id.* § 1605(a)(1)-(6). With respect to some types of charges (*e.g.*, insurance premiums payable by the debtor), Congress also provided rules for determining inclusion or exclusion from the finance charge. *See id.* § 1605(a)-(c). And §1605 specifically exempts various other fees and charges from the finance charge. *See id.* § 1605(a), (d), (e). The fact

[6] This premise of the Court's *Milhollin* decision has held true in practice. Since TILA's enactment, the Board has undertaken numerous studies of consumer psychology and credit practices, making it particularly well-suited to identify those rules that best serve TILA's purpose of according consumers meaningful disclosure of the costs of credit. *See, e.g.*, Marianne A. Hilgert et al., *Household Financial Management: The Connection Between Knowledge and Behavior*, Fed. Reserve Bull. 309 (July 2003); Thomas A. Durkin, *Consumers and Credit Disclosures: Credit Cards and Credit Insurance*, Fed. Reserve Bull. 201 (Apr. 2002).

that the statute fleshes out its general definition by specifying over 15 additional rules for determining when certain types of charges must be included in the finance charge shows that Congress itself recognized the ambiguity of the general "finance charge" definition in § 1605(a).

None of these additional rules refers to over-limit fees. TILA does not state anywhere whether fees imposed on consumers for exceeding their credit limits must be included in the finance charge, or instead disclosed separately as other charges. TILA does make it clear, however, that not every charge imposed in connection with a credit plan must be included as part of the finance charge. With respect specifically to open-end consumer credit plans *(e.g.*, credit cards and charge cards), TILA requires creditors to disclose to consumers prior to the opening of any account not only "[t]he conditions under which a *finance charge* may be imposed" and "[t]he method of determining the amount of the *finance charge*," but also any "*other charges* which may be imposed as part of the plan, and their method of computation." 15 U.S.C. § 1637(a)(1), (3), (5) (emphases added). Although every charge to a credit card customer could be described in some sense as "an incident to the extension of credit," Congress clearly expected some charges to be treated as "other charges." The statute provides that creditors' disclosures of "other charges" shall take place "in accordance with regulations of the Board." *Id.* § 1637(a)(5).

TILA refers specifically to over-limit fees in only one context, and it illustrates the precise ambiguity at issue here. In 1988 Congress added new disclosure requirements to the statute to govern applications and solicitations for credit cards and charge cards. *See* 15 U.S.C. § 1637(c) (added by Fair Credit and Charge Card Disclosure Act of 1988, Pub. L. No. 100-583, § 2(a), 102 Stat. 2960). For purposes of these disclosures, TILA defines a "charge card" as "a card, plate, or other single credit device that may be used from time to time to obtain credit *which is not subject to a finance charge*." 15 U.S.C. § 1637(c)(4)(E) (emphasis added). Even though Congress thus recognized a charge



card account as one that does not have a "finance charge," it also expressly noted that there may be "[o]ver-the-limit fee[s]" on such accounts, and it required that solicitations and applications disclose such fees. *Id.* § 1637(c)(4)(B)(iii); *see also id.* § 1637(c)(1)(B)(iii) (parallel provision for credit cards). This treatment of over-limit fees as *not* constituting finance charges shows that Congress itself, in the same statute, thought the two could be treated as separate.

The general definition of "finance charge"—"the sum of all charges . . . imposed . . . as an incident to the extension of credit," 15 U.S.C. § 1605(a)—is also ambiguous with respect to the issue in this case in a more specific way. The statute defines "credit," in turn, as "*the right* granted by a creditor to a debtor to defer payment of debt or *to incur debt and defer its payment.*" *Id.* § 1602(e) (emphases added). An over-limit fee, however, is by definition not charged as a fee for exercising a "right" to incur debt and defer payment, but instead as a fee for having *breached the contractual limits* on the cardholder's right to do so. As Congress itself recognized, "over-the-limit fees . . . accrue for misuse of the account." S. Rep. No. 100-259, at 6 (1987), *reprinted in* 1988 U.S.C.C.A.N. 3936, 3942. At the very least, the Board could rationally choose to classify over-limit fees as charges for breach of the borrowing agreement rather than for the exercise of a "right" to borrow.

### III. The Board's Regulation Excluding Over-Limit Fees From The Finance Charge Is Not Demonstrably Irrational.

Because TILA does not specifically address whether over-limit fees must be included in the finance charge, the Board's Regulation Z fills this gap. It provides that "[c]harges for actual unanticipated late payment, *for exceeding a credit limit*, or for delinquency, default, or a similar occurrence" are not finance charges. 12 C.F.R. § 226.4(c)(2) (emphasis added). That regulatory classification is a rational implementation of the statute.

The Sixth Circuit agreed that the Board may properly treat other fees charged to consumers for breaches of their

credit card agreements—such as late payment and default fees—as "other charges" and exclude them from the finance charge. *See* Pet. App. A13-A14. The panel majority, however, believed that a transaction in which a credit card holder exceeds her credit limit may sometimes involve a "request" for "additional credit" that is "knowingly allowed" by the creditor (*id.* at A13), and concluded that TILA requires any charge imposed in such a case to be classified as a "finance charge." *See id.* at A9-A15.[7]

In ruling that the Board's "regulation cannot stand" (Pet. App. A12), the Sixth Circuit failed to accord a proper measure of deference to the Board's authority to implement disclosure requirements based on its experience and judgment in the consumer credit field. The Sixth Circuit substituted its own "liberal" interpretation of TILA for the reasonable construction selected by the Board. The Sixth Circuit's primary basis for its decision was its view that "TILA, as a remedial statute, must be given a liberal interpretation in favor of consumers in order to protect them in credit transactions." Pet. App. A8-A9; *see also id.* at A19 ("The district court erred in failing to construe TILA liberally in Plaintiff's favor . . . ."). In the Sixth Circuit's view, the inclusion of over-limit fees in the finance charge is necessitated by "TILA's statutory goal of providing adequate disclosure in order that the consumer will knowledgeably be able to compare credit options and 'avoid

[7] In using words such as "requested," "knowingly allowed," and "knowingly permits," the Sixth Circuit over-read the complaint, which does not allege that respondent asked petitioners for, or that petitioners agreed to give respondent, a right to exceed her credit limit. Respondent's own characterization of a credit card transaction as being "allowed" to proceed over a credit limit (Pet. App. A39) is merely a reference to the fact that credit cards are accepted as payment instruments by merchants who ordinarily obtain "authorization" from the credit card system. *See supra*, p. 14 n.4; *see also* Brief of Appellant in the Sixth Circuit at 14. In any event, the lawfulness of the Board's regulation and the deference due it from the Sixth Circuit do not properly depend on that court's assumptions about how the credit card system works.



the uninformed use of credit.'" *Id.* at A12 (quoting 15 U.S.C. § 1601(a)).

But Congress has made it clear that the Board, and not the courts, can best determine how to achieve the disclosure TILA seeks. As this Court has explained, "[t]he concept of meaningful disclosure that animates TILA cannot be applied in the abstract. *Meaningful* disclosure does not mean *more* disclosure. Rather, it describes a balance between competing considerations of complete disclosure and the need to avoid informational overload." *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 568 (1980) (internal quotation marks, citations, and alterations omitted). Identifying the rule that achieves the appropriate balance in this disclosure context is "an empirical process that entails investigation into consumer psychology and that presupposes broad experience with credit practice." *Id.* at 568-69. For this reason, Congress delegated broad rulemaking power to the Board, the institution with such knowledge and experience. TILA evinces "a decided preference for resolving interpretive issues by uniform administrative decision, rather than piecemeal through litigation." *Id.* at 568. The Sixth Circuit effectively ignored these well-established principles of deference in the TILA context by arrogating to itself the policy decision whether the inclusion of certain over-limit fees in the finance charge would best achieve TILA's purposes.

The Board has the authority to draw reasonable lines, not only as an incident of its general rulemaking power but also by virtue of its explicit statutory authority to create regulatory "classifications." 15 U.S.C. § 1604(a). For sound reasons, including TILA's goals of clarity for creditors and borrowers, the Board has excluded over-limit fees as a class from the "finance charge."

Congress amended TILA in 1980 to both "provide the consumer with clearer credit information, [and] make creditor compliance easier." S. Rep. No. 96-73, at 2 (1979), *reprinted in* 1980 U.S.C.C.A.N. 280, 280. Heeding Congress's directions, the Board amended Regulation Z to serve these purposes.

*First*, the Board explained in its notice of proposed rulemaking that its amendments to Regulation Z would "substitute[], where possible, precise, easily-applied rules for principles that create ambiguity and require additional regulatory clarification." 45 Fed. Reg. 80648, 80648 (Dec. 5, 1980). The Board determined that "simplification [would] produce disclosures that [were] simpler, easier to understand, and in a form more readily useable by consumers." *Id.* *Second*, the Board revised Regulation Z to emphasize the disclosures most "relevant to credit decisions, as opposed to disclosures related to events occurring after the initial credit choice." *Id.* at 80649. As the Board explained, "the primary goals of the Truth in Lending Act are not particularly enhanced by regulatory provisions relating to changes in terms on outstanding obligations and on the effects of the failure to comply with the terms of the obligation." *Id.* *Third*, the Board determined not to impose regulatory requirements if they would "impose any burdens on the credit-granting process that [could not] be fully justified by consumer benefits." *Id.* The Board stated that its regulatory cost-benefit analysis turned on numerous factors, including "the complexity of the disclosures ... needed to comply with [a particular regulatory requirement], and the extent to which [the requirement] is likely to further the general statutory goals of providing certain basic information to facilitate credit shopping." *Id.*

The Board's express exclusion of over-limit fees from the finance charge followed from the Board's stated purposes with regard to the revision of Regulation Z generally. By applying a bright-line rule, the Board provided creditors a straightforward, easily-applied standard that could be applied in uniform, consistent, and meaningful disclosure statements for consumers.

No consumer interest required the Board to adopt instead an approach like that of the Sixth Circuit, which would treat identical over-limit charges sometimes as part of the "finance charge" and sometimes not depending on the facts surrounding a particular purchase and borrowing. On the contrary, because the treatment of an over-limit fee



under the Sixth Circuit's rule depends on the *creditor's* state of knowledge—and not the *cardholder's* behavior—the Sixth Circuit's rule would likely confuse cardholders by potentially requiring disparate disclosures of over-limit fees that were in all pertinent respects identically incurred.

This confusion is illustrated by the following hypothetical. Assume that a cardholder makes charges on two different credit cards (issued by two different creditors) in the same month, each of which causes the respective account to exceed its credit limit. Assume further that the first creditor knew at the time that the charge was made on its card that the transaction would cause the cardholder's account to exceed her credit limit, knew that it would impose an over-limit fee as a result of that transaction, and approved the charge. Finally, assume that the second creditor lacked knowledge that the charge on its card would take the cardholder over limit. If both creditors impose over-limit fees due to these charges, the Sixth Circuit rule would require different disclosure treatment for each over-limit fee. The first creditor would be required to include the over-limit fee in the disclosed finance charge and compute the annual percentage rate accordingly. The second creditor, however, would be required to exclude the over-limit fee from the finance charge and disclose it separately as an "other charge[]." From the perspective of the cardholder—who is unaware of the creditors' differing states of knowledge at the time the cardholder's charges were processed—the two situations are indistinguishable, yet her periodic billing statements look vastly different. With good reason, the cardholder would experience substantial confusion about her billing statements and the comparable costs of credit.

The Board's regulation, which instead provides for the uniform treatment of over-limit fees across creditors based on the actions of the *cardholder*, avoids this needless confusion without sacrificing any apparent consumer benefits. That regulatory choice surely cannot be termed "demonstrably irrational." *Milhollin*, 444 U.S. at 565.

The Board's classification of over-limit fees on a general basis as "other charges" also "facilitate[s] compliance" with TILA. 15 U.S.C. § 1604(a). The Sixth Circuit's rule, which turns on (among other things) the creditor's particular knowledge at the time it "permits" a cardholder's charges to be processed, would apparently require a creditor to create, maintain, and consult, new types of records containing all the account balance information available to it at the moment of every merchant authorization it gives for any transaction that may lead to an over-limit charge. As the Board explained in its proposed rulemaking in 1980, the imposition of such needless burdens on creditors ultimately disadvantages consumers—the intended beneficiaries of TILA. "[A]s a general matter regulatory burdens on the credit-granting process may adversely affect consumer access to credit, and certainly have a bearing on its relative costs. To the extent that these burdens can be reduced, there should be a beneficial effect on the availability and cost of credit." 45 Fed. Reg. at 80648. By facilitating creditors' compliance with TILA, the Board's exclusion of over-limit fees from the "finance charge" constitutes a rational and proper exercise of the Board's classification power.

Although the Sixth Circuit declined to consider it, the Board's amicus brief in that court explained many of the reasons why its classification of over-limit charges as "other charges" was a rational exercise of its judgment and discretion based on its expert knowledge of the credit system and consumer disclosures. *See* Pet. App. A47-A51. Credit card issuers generally cannot reliably determine, at the time a cardholder uses a credit card in a transaction, whether the charge will cause the account to exceed its credit limit and incur an over-limit charge. Accordingly, the Board has no reason to include such a knowledge element in its regulation concerning over-limit fees. Indeed, imposition of an approach like the one favored by the Sixth Circuit panel would render compliance more difficult for creditors, thereby upsetting a principal purpose of TILA, as amended by the Simplification Act. The Sixth Circuit's rule would require creditors to develop new and costly systems to



create, capture, and record new kinds of information about account status at the time of any transaction that might ultimately form the basis for an over-limit charge. The development of such new and complex systems would impose enormous costs on the credit card industry, with no apparent benefit to the affected cardholders. The Board's choice of an easily-applied, uniform regulation of over-limit fees instead of a rule requiring such burdensome compliance efforts is not demonstrably irrational, but instead falls well within the Board's power to utilize regulatory classifications "to facilitate compliance" with TILA. 15 U.S.C. § 1604(a).

## CONCLUSION

Because petitioners complied with a lawful regulation, the judgment of the Sixth Circuit should be reversed and the district court's decision dismissing respondent's complaint for failure to state a claim should be reinstated.

Respectfully submitted,

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## APPENDIX

## 15 U.S.C. § 1637

§ 1637. Open end consumer credit plans

(a) Required disclosures by creditor

Before opening any account under an open end consumer credit plan, the creditor shall disclose to the person to whom credit is to be extended each of the following items, to the extent applicable:

**(1)** The conditions under which a finance charge may be imposed, including the time period (if any) within which any credit extended may be repaid without incurring a finance charge, except that the creditor may, at his election and without disclosure, impose no such finance charge if payment is received after the termination of such time period. If no such time period is provided, the creditor shall disclose such fact.

**(2)** The method of determining the balance upon which a finance charge will be imposed.

**(3)** The method of determining the amount of the finance charge, including any minimum or fixed amount imposed as a finance charge.

**(4)** Where one or more periodic rates may be used to compute the finance charge, each such rate, the range of balances to which it is applicable, and the corresponding nominal annual percentage rate determined by multiplying the periodic rate by the number of periods in a year.

**(5)** Identification of other charges which may be imposed as part of the plan, and their method of computation, in accordance with regulations of the Board.

**(6)** In cases where the credit is or will be secured, a statement that a security interest has been or will be

taken in (A) the property purchased as part of the credit transaction, or (B) property not purchased as part of the credit transaction identified by item or type.

**(7)** A statement, in a form prescribed by regulations of the Board of the protection provided by sections 1666 and 1666i of this title to an obligor and the creditor's responsibilities under sections 1666a and 1666i of this title. With respect to one billing cycle per calendar year, at intervals of not less than six months or more than eighteen months, the creditor shall transmit such statement to each obligor to whom the creditor is required to transmit a statement pursuant to subsection (b) of this section for such billing cycle.

**(8)** In the case of any account under an open end consumer credit plan which provides for any extension of credit which is secured by the consumer's principal dwelling, any information which--

**(A)** is required to be disclosed under section 1637a(a) of this title; and

**(B)** the Board determines is not described in any other paragraph of this subsection.

(b) Statement required with each billing cycle

The creditor of any account under an open end consumer credit plan shall transmit to the obligor, for each billing cycle at the end of which there is an outstanding balance in that account or with respect to which a finance charge is imposed, a statement setting forth each of the following items to the extent applicable:

**(1)** The outstanding balance in the account at the beginning of the statement period.

**(2)** The amount and date of each extension of credit during the period, and a brief identification, on or accompanying the statement of each extension of credit in a form prescribed by the Board sufficient to enable the obligor either to identify the transaction or to relate it to [illegible] of sales vouchers or similar instruments



previously furnished, except that a creditor's failure to disclose such information in accordance with this paragraph shall not be deemed a failure to comply with this part or this subchapter if (A) the creditor maintains procedures reasonably adapted to procure and provide such information, and (B) the creditor responds to and treats any inquiry for clarification or documentation as a billing error and an erroneously billed amount under section 1666 of this title. In lieu of complying with the requirements of the previous sentence, in the case of any transaction in which the creditor and seller are the same person, as defined by the Board, and such person's open end credit plan has fewer than 15,000 accounts, the creditor may elect to provide only the amount and date of each extension of credit during the period and the seller's name and location where the transaction took place if (A) a brief identification of the transaction has been previously furnished, and (B) the creditor responds to and treats any inquiry for clarification or documentation as a billing error and an erroneously billed amount under section 1666 of this title.

**(3)** The total amount credited to the account during the period.

**(4)** The amount of any finance charge added to the account during the period, itemized to show the amounts, if any, due to the application of percentage rates and the amount, if any, imposed as a minimum or fixed charge.

**(5)** Where one or more periodic rates may be used to compute the finance charge, each such rate, the range of balances to which it is applicable, and, unless the annual percentage rate (determined under section 1606(a)(2) of this title) is required to be disclosed pursuant to paragraph (6), the corresponding nominal annual percentage rate determined by multiplying the periodic rate by the number of periods in a year.

**(6)** Where the total finance charge exceeds 50 cents for a monthly or longer billing cycle, or the pro rata part

of 50 cents for a billing cycle shorter than monthly, the total finance charge expressed as an annual percentage rate (determined under section 1606(a)(2) of this title), except that if the finance charge is the sum of two or more products of a rate times a portion of the balance, the creditor may, in lieu of disclosing a single rate for the total charge, disclose each such rate expressed as an annual percentage rate, and the part of the balance to which it is applicable.

**(7)** The balance on which the finance charge was computed and a statement of how the balance was determined. If the balance is determined without first deducting all credits during the period, that fact and the amount of such payments shall also be disclosed.

**(8)** The outstanding balance in the account at the end of the period.

**(9)** The date by which or the period (if any) within which, payment must be made to avoid additional finance charges, except that the creditor may, at his election and without disclosure, impose no such additional finance charge if payment is received after such date or the termination of such period.

**(10)** The address to be used by the creditor for the purpose of receiving billing inquiries from the obligor.

(c) Disclosure in credit and charge card applications and solicitations

**(1)** Direct mail applications and solicitations

(A) Information in tabular format

Any application to open a credit card account for any person under an open end consumer credit plan, or a solicitation to open such an account without requiring an application, that is mailed to consumers shall disclose the following information, subject to subsection (e) of this section and section 1632(c) of this title:



(i) Annual percentage rates

**(I)** Each annual percentage rate applicable to extensions of credit under such credit plan.

**(II)** Where an extension of credit is subject to a variable rate, the fact that the rate is variable, the annual percentage rate in effect at the time of the mailing, and how the rate is determined.

**(III)** Where more than one rate applies, the range of balances to which each rate applies.

(ii) Annual and other fees

**(I)** Any annual fee, other periodic fee, or membership fee imposed for the issuance or availability of a credit card, including any account maintenance fee or other charge imposed based on activity or inactivity for the account during the billing cycle.

**(II)** Any minimum finance charge imposed for each period during which any extension of credit which is subject to a finance charge is outstanding.

**(III)** Any transaction charge imposed in connection with use of the card to purchase goods or services.

(iii) Grace period

**(I)** The date by which or the period within which any credit extended under such credit plan for purchases of goods or services must be repaid to avoid incurring a finance charge, and, if no such period is offered, such fact shall be clearly stated.

**(II)** If the length of such "grace period" varies, the card issuer may disclose the range of days in the grace period, the minimum number of days in the grace period, or the average number of days in

the grace period, if the disclosure is identified as such.

(iv) Balance calculation method

(I) The name of the balance calculation method used in determining the balance on which the finance charge is computed if the method used has been defined by the Board, or a detailed explanation of the balance calculation method used if the method has not been so defined.

(II) In prescribing regulations to carry out this clause, the Board shall define and name not more than the 5 balance calculation methods determined by the Board to be the most commonly used methods.

(B) Other information

In addition to the information required to be disclosed under subparagraph (A), each application or solicitation to which such subparagraph applies shall disclose clearly and conspicuously the following information, subject to subsections (e) and (f) of this section:

(i) Cash advance fee

Any fee imposed for an extension of credit in the form of cash.

(ii) Late fee

Any fee imposed for a late payment.

(iii) Over-the-limit fee

Any fee imposed in connection with an extension of credit in excess of the amount of credit



authorized to be extended with respect to such account.

(2) Telephone solicitations

(A) In general

In any telephone solicitation to open a credit card account for any person under an open end consumer credit plan, the person making the solicitation shall orally disclose the information described in paragraph (1)(A).

(B) Exception

Subparagraph (A) shall not apply to any telephone solicitation if--

(i) the credit card issuer--

(I) does not impose any fee described in paragraph (1)(A)(ii)(I); or

(II) does not impose any fee in connection with telephone solicitations unless the consumer signifies acceptance by using the card;

(ii) the card issuer discloses clearly and conspicuously in writing the information described in paragraph (1) within 30 days after the consumer requests the card, but in no event later than the date of delivery of the card; and

(iii) the card issuer discloses clearly and conspicuously that the consumer is not obligated to accept the card or account and the consumer will not be obligated to pay any of the fees or charges disclosed unless the consumer elects to accept the card or account by using the card.

(3) Applications and solicitations by other means

(A) In general

Any application to open a credit card account for any person under an open end consumer credit plan, and any solicitation to open such an account without requiring an application, that is made available to the public or contained in catalogs, magazines, or other publications shall meet the disclosure requirements of subparagraph (B), (C), or (D).

(B) Specific information

An application or solicitation described in subparagraph (A) meets the requirement of this subparagraph if such application or solicitation contains--

(i) the information--

(I) described in paragraph (1)(A) in the form required under section 1632(c) of this title, subject to subsection (e) of this section, and

(II) described in paragraph (1)(B) in a clear and conspicuous form, subject to subsections (e) and (f) of this section;

(ii) a statement, in a conspicuous and prominent location on the application or solicitation, that--

(I) the information is accurate as of the date the application or solicitation was printed;

(II) the information contained in the application or solicitation is subject to change after such date; and

(III) the applicant should contact the creditor for information on any change in the information contained in the application or solicitation since it was printed;

(iii) a clear and conspicuous disclosure of the date the application or solicitation was printed; and

(iv) a disclosure, in a conspicuous and prominent location on the application or solicitation,



of a toll free telephone number or a mailing address at which the applicant may contact the creditor to obtain any change in the information provided in the application or solicitation since it was printed.

(C) General information without any specific term

An application or solicitation described in subparagraph (A) meets the requirement of this subparagraph if such application or solicitation--

(i) contains a statement, in a conspicuous and prominent location on the application or solicitation, that--

(I) there are costs associated with the use of credit cards; and

(II) the applicant may contact the creditor to request disclosure of specific information of such costs by calling a toll free telephone number or by writing to an address, specified in the application;

(ii) contains a disclosure, in a conspicuous and prominent location on the application or solicitation, of a toll free telephone number and a mailing address at which the applicant may contact the creditor to obtain such information; and

(iii) does not contain any of the items described in paragraph (1).

(D) Applications or solicitations containing subsection (a) disclosures

An application or solicitation meets the requirement of this subparagraph if it contains, or is accompanied by--

(i) the disclosures required by paragraphs (1) through (6) of subsection (a) of this section;

(ii) the disclosures required by subparagraphs (A) and (B) of paragraph (1) of this subsection

included clearly and conspiciously[1] (except that the provisions of section 1632(c) of this title shall not apply); and

(iii) a toll free telephone number or a mailing address at which the applicant may contact the creditor to obtain any change in the information provided.

(E) Prompt response to information requests

Upon receipt of a request for any of the information referred to in subparagraph (B), (C), or (D), the card issuer or the agent of such issuer shall promptly disclose all of the information described in paragraph (1).

(4) Charge card applications and solicitations

(A) In general

Any application or solicitation to open a charge card account shall disclose clearly and conspicuously the following information in the form required by section 1632(c) of this title, subject to subsection (e) of this section:

(i) Any annual fee, other periodic fee, or membership fee imposed for the issuance or availability of the charge card, including any account maintenance fee or other charge imposed based on activity or inactivity for the account during the billing cycle.

(ii) Any transaction charge imposed in connection with use of the card to purchase goods or services.

(iii) A statement that charges incurred by use of the charge card are due and payable upon receipt

[1] So in original. Probably should be "conspicuously".



of a periodic statement rendered for such charge card account.

(B) Other information

In addition to the information required to be disclosed under subparagraph (A), each written application or solicitation to which such subparagraph applies shall disclose clearly and conspicuously the following information, subject to subsections (e) and (f) of this section:

(i) Cash advance fee

Any fee imposed for an extension of credit in the form of cash.

(ii) Late fee

Any fee imposed for a late payment.

(iii) Over-the-limit fee

Any fee imposed in connection with an extension of credit in excess of the amount of credit authorized to be extended with respect to such account.

(C) Applications and solicitations by other means

Any application to open a charge card account, and any solicitation to open such an account without requiring an application, that is made available to the public or contained in catalogs, magazines, or other publications shall contain--

(i) the information--

(I) described in subparagraph (A) in the form required under section 1632(c) of this title, subject to subsection (e) of this section, and

(II) described in subparagraph (B) in a clear and conspicuous form, subject to subsections (e) and (f) of this section;

(ii) a statement, in a conspicuous and prominent location on the application or solicitation, that--

(I) the information is accurate as of the date the application or solicitation was printed;

(II) the information contained in the application or solicitation is subject to change after such date; and

(III) the applicant should contact the creditor for information on any change in the information contained in the application or solicitation since it was printed;

(iii) a clear and conspicuous disclosure of the date the application or solicitation was printed; and

(iv) a disclosure, in a conspicuous and prominent location on the application or solicitation, of a toll free telephone number or a mailing address at which the applicant may contact the creditor to obtain any change in the information provided in the application or solicitation since it was printed.

(D) Issuers of charge cards which provide access to open end consumer credit plans

If a charge card permits the card holder to receive an extension of credit under an open end consumer credit plan, which is not maintained by the charge card issuer, the charge card issuer may provide the information described in subparagraphs (A) and (B) in the form required by such subparagraphs in lieu of the information required to be provided under paragraph (1), (2), or (3) with respect to any credit extended under such plan, if the charge card issuer discloses clearly and conspicuously to the consumer in the application or solicitation that--



(i) the charge card issuer will make an independent decision as to whether to issue the card;

(ii) the charge card may arrive before the decision is made with respect to an extension of credit under an open end consumer credit plan; and

(iii) approval by the charge card issuer does not constitute approval by the issuer of the extension of credit.

The information required to be disclosed under paragraph (1) shall be provided to the charge card holder by the creditor which maintains such open end consumer credit plan before the first extension of credit under such plan.

(E) Charge card defined

For the purposes of this subsection, the term "charge card" means a card, plate, or other single credit device that may be used from time to time to obtain credit which is not subject to a finance charge.

(5) Regulatory authority of the Board

The Board may, by regulation, require the disclosure of information in addition to that otherwise required by this subsection or subsection (d) of this section, and modify any disclosure of information required by this subsection or subsection (d) of this section, in any application to open a credit card account for any person under an open end consumer credit plan or any application to open a charge card account for any person, or a solicitation to open any such account without requiring an application, if the Board determines that such action is necessary to carry out the purposes of, or prevent evasions of, any paragraph of this subsection.

(d) Disclosure prior to renewal

(1) In general

Except as provided in paragraph (2), a card issuer that imposes any fee described in subsection (c)(1)(A)(ii)(I) or (c)(4)(A)(i) of this section shall transmit to a consumer at least 30 days prior to the scheduled renewal date of the consumer's credit or charge card account a clear and conspicuous disclosure of--

**(A)** the date by which, the month by which, or the billing period at the close of which, the account will expire if not renewed;

**(B)** the information described in subsection (c)(1)(A) or (c)(4)(A) of this section that would apply if the account were renewed, subject to subsection (e) of this section; and

**(C)** the method by which the consumer may terminate continued credit availability under the account.

(2) Special rule for certain disclosures

(A) In general

The disclosures required by this subsection may be provided--

**(i)** prior to posting a fee described in subsection (c)(1)(A)(ii)(I) or (c)(4)(A)(i) of this section to the account, or

**(ii)** with the periodic billing statement first disclosing that the fee has been posted to the account.

(B) Limitation on use of special rule

Disclosures may be provided under subparagraph (A) only if--

**(i)** the consumer is given a 30-day period to avoid payment of the fee or to have the fee



recredited to the account in any case where the consumer does not wish to continue the availability of the credit; and

**(ii)** the consumer is permitted to use the card during such period without incurring an obligation to pay such fee.

(3) Short-term renewals

The Board may by regulation provide for fewer disclosures than are required by paragraph (1) in the case of an account which is renewable for a period of less than 6 months.

(e) Other rules for disclosures under subsections (c) and (d)

(1) Fees determined on the basis of a percentage

If the amount of any fee required to be disclosed under subsection (c) or (d) of this section is determined on the basis of a percentage of another amount, the percentage used in making such determination and the identification of the amount against which such percentage is applied shall be disclosed in lieu of the amount of such fee.

(2) Disclosure only of fees actually imposed

If a credit or charge card issuer does not impose any fee required to be disclosed under any provision of subsection (c) or (d) of this section, such provision shall not apply with respect to such issuer.

(f) Disclosure of range of certain fees which vary by State allowed

If the amount of any fee required to be disclosed by a credit or charge card issuer under paragraph (1)(B), (3)(B)(i)(II), (4)(B), or (4)(C)(i)(II) of subsection (c) of this section varies from State to State, the card issuer may

disclose the range of such fees for purposes of subsection (c) of this section in lieu of the amount for each applicable State, if such disclosure includes a statement that the amount of such fee varies from State to State.

(g) Insurance in connection with certain open end credit card plans

(1) Change in insurance carrier

Whenever a card issuer that offers any guarantee or insurance for repayment of all or part of the outstanding balance of an open end credit card plan proposes to change the person providing that guarantee or insurance, the card issuer shall send each insured consumer written notice of the proposed change not less than 30 days prior to the change, including notice of any increase in the rate or substantial decrease in coverage or service which will result from such change. Such notice may be included on or with the monthly statement provided to the consumer prior to the month in which the proposed change would take effect.

(2) Notice of new insurance coverage

In any case in which a proposed change described in paragraph (1) occurs, the insured consumer shall be given the name and address of the new guarantor or insurer and a copy of the policy or group certificate containing the basic terms and conditions, including the premium rate to be charged.

(3) Right to discontinue guarantee or insurance

The notices required under paragraphs (1) and (2) shall each include a statement that the consumer has the option to discontinue the insurance or guarantee.

(4) No preemption of State law



No provision of this subsection shall be construed as superseding any provision of State law which is applicable to the regulation of insurance.

(5) Board definition of substantial decrease in coverage or service

The Board shall define, in regulations, what constitutes a "substantial decrease in coverage or service" for purposes of paragraph (1).

Supreme Court, U.S.
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No. 02-857

IN THE

# Supreme Court of the United States

HOUSEHOLD CREDIT SERVICES, INC.
and MBNA AMERICA BANK, N.A.,

*Petitioners,*

*v.*

SHARON R. PFENNIG,

*Respondent.*

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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## STATEMENT

Respondent, Sharon R. Pfennig, brought this class action against Petitioners, Household Credit Services, Inc. and MBNA America Bank, N.A, for failing to disclose the true cost of credit extended by Petitioners in violation of the Truth in Lending Act ("TILA"), 15 U.S.C. § 1601, *et seq.* and its implementing regulation, Regulation Z, 12 C.F.R. § 226.

Petitioners moved to dismiss Respondent's complaint, arguing that she failed to state a claim upon which relief could be granted because Regulation Z authorized Petitioners' conduct. The question before the Court is whether Respondent has alleged facts in her complaint that, if proved true, would entitle her to relief.

*1. Respondent's Complaint.* Respondent is a holder of Petitioners' credit card. *See* Complaint at ¶ 5. Petitioners established a credit limit of $2000 for this credit card. *See* Complaint at ¶ 34.

A "credit limit" represents the amount of credit the card issuer has pre-approved the consumer to obtain. In open-end consumer credit plans like the one at issue here, every purchase made by the consumer is its own "extension of credit" and must be disclosed as such. *See* 15 U.S.C. § 1637(b)(2). So, every time Respondent sought to make a purchase using her credit card, she requested that Petitioners make an extension of credit to her in the precise amount of the purchase. Generally, all requests up to the pre-set limit would be approved.

This case involves a request for an extension of credit that took Respondent beyond the stated $2000 credit limit.

Nothing in the underlying cardholder agreement prohibited Respondent from making that request. Likewise, nothing in the underlying cardholder agreement required Petitioners to approve it. However, in this instance, Petitioners chose to approve Respondent's request for the extension of credit that resulted in her exceeding her credit limit. *See* Complaint at ¶ 7.

After approving this request for an additional extension of credit, Petitioners charged Respondent a $29 fee for doing so. *See* Complaint at ¶ 8. This charge was labeled an "Overlimit Charge Assessment" and was posted to Respondent's account as "Purchases and Other Charges" on which additional financing charges are calculated. *See* Complaint at ¶ 9. In other words, Respondent was charged $29 plus interest for the extension of credit authorized by Petitioners. The cost of this authorized extension of credit was never disclosed as part of the finance charge as required by TILA and Regulation Z. *See, e.g.*, Complaint at ¶¶ 9, 36, 39.

Petitioners answered Respondent's complaint by arguing that Regulation Z allows them to exclude from the finance charge a fee denominated an "over-the-limit" fee. However, the regulation excludes from the finance charge fees imposed for unilateral acts of default, not authorized extensions of credit. *See* 12 C.F.R. § 226.4(c)(2); 12 C.F.R. Part 226, Supp. I, Official Staff Commentary at § 226.4(c)(2)-1. Therefore, if Petitioners authorized the extension of credit to Respondent as alleged in her complaint, the cited regulation does not apply.

*2. The Purpose of TILA and Regulation Z.* TILA is a consumer protection statute intended to guarantee that the



true cost of credit is disclosed to consumers so as to enable them to make informed choices in the credit marketplace. *See* 15 U.S.C. § 1601 ("The informed use of credit results from an awareness of the costs thereof by consumers.").

"The Truth in Lending Act has the broad purpose of promoting 'the informed use of credit' by assuring meaningful disclosure of credit terms' to consumers." *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 559 (1980).

> The 1967 Committee Reports [accompanying TILA] explained that "by requiring all creditors to disclose credit information in a uniform manner, and by requiring all additional mandatory charges imposed by the creditor as an incident to credit [to] be included in the computation of the applicable percentage rate, the American consumer will be given the information he needs to compare the costs of credit and to make the best informed decision on the use of credit."

*See Anderson Bros. Ford v. Valencia*, 452 U.S. 205, 220, n.17 (1981) (quoting H.R. Rep. No. 1040, 90th Cong., 1st Sess., 13; S. Rep. No. 392, 90th Cong., 1st Sess., 3). *See also Mourning v. Family Publications Service, Inc.*, 411 U.S. 356, 377 (1973) ("The Truth in Lending Act reflects a transition in congressional policy from a philosophy of 'Let the buyer beware' to one of 'Let the seller disclose.'").

"Because of their complexity and variety, however, credit transactions defy exhaustive regulation by a single statute. Congress therefore delegated expansive authority to the Federal Reserve Board to elaborate and expand the legal framework governing commerce in credit." *Milhollin*,

444 U.S. at 559-560. This broad authority was designed to enable the Board to prevent circumvention of the cost disclosure requirements of the statute:

> Section 105 delegated to the Federal Reserve Board broad authority to promulgate regulations necessary to render the Act effective. The language employed evinces the awareness of Congress that some creditors would attempt to characterize their transactions so as to fall one step outside whatever boundary Congress attempted to establish. It indicates as well the clear desire of Congress to insure that the Board had adequate power to deal with such attempted evasion.

*See Mourning*, 411 U.S. at 365.

*3. The Sixth Circuit's Decision.* Respondent's complaint does not challenge the Board's authority. Based on the purpose and plain language of TILA and Regulation Z, the Sixth Circuit determined that the fee imposed by Petitioners, although characterized as an "over-the-limit" fee, is actually a finance charge in disguise. *See* Cert. Pet. App. A13. The court commented that this determination rested on Respondent's allegations that Petitioners *authorized* the extension of credit for which a fee was imposed:

> [C]onstruing the allegations in the complaint in the light most favorable to Plaintiff, she clearly alleges that Defendants had foreknowledge of her over-limit charges. In addition, these allegations support Plaintiff's argument that Defendants make the decision as to whether over-limit charges "will be permitted to go through." While the dissent



> claims credit card issuers "may not, in all cases" make such decisions, such a hypothetical scenario is not before us. Plaintiff has alleged in her complaint that Defendants routinely allow consumers to exceed their applicable credit limits. Thus, she has alleged that the ultimate decisions squarely rests in the hands of Defendants. Contrary to the dissent's contention, our holding is of course limited to those instances in which the creditor knowingly permits the credit card holder to exceed his or her credit limit and then imposes a fee incident to the extension of that credit.

*See* Cert. Pet. App. A15 n.5.

Petitioners accuse the Sixth Circuit of "rejecting" the Board's authority by "substitut[ing] a fact-dependent test of its own making" for the bright-line test of the regulation. *See* Pet. Brief at 11. However, the court's limitation of its holding is consistent with TILA's description of a true "over-the-limit" fee and the Board's incorporation of this notion in 12 C.F.R. § 226.4(c)(2).

As the Government acknowledges, TILA describes an "over-the-limit" fee as a "fee imposed in connection with an extension of credit in excess of the amount of credit authorized to be extended with respect to [the] account." *See* Gov't Brief at 2 (quoting 15 U.S.C. § 1637(c)(1)(B)(iii)). Consistent with this description, the Board excluded from the finance charge fees for unilateral acts of default such as exceeding a credit limit without the creditor's authorization. *See* 12 C.F.R. § 226.4(c)(2); 12 C.F.R. Part 226, Supp. I, Official Staff Commentary at § 226.4(c)(2)-1.

Therefore, if Petitioners authorized additional credit to be extended to Respondent as alleged in her complaint, by definition the fee imposed for this additional credit is not and cannot be an "over-the-limit" fee excluded from the finance charge. For the Sixth Circuit to draw this distinction based on the specific allegations of Respondent's complaint does not challenge the Board's authority.

## SUMMARY OF ARGUMENT

Before this Court is a motion to dismiss. The core question is whether Respondent can prove any set of facts entitling her to relief under TILA. Respondent's complaint alleges that Petitioners authorized an extension of credit to her and imposed a fee for doing so. *See* Complaint at ¶¶ 7, 8. The complaint avers that this fee – a fee inextricably tied to an authorized extension of credit – is a finance charge pursuant to the express terms of TILA and Regulation Z. *See* Complaint at ¶ 35. These allegations, if proved true, demonstrate Petitioners' TILA violation. Therefore, per the pleading standard of *Conley v. Gibson*, 355 U.S. 41 (1957), Respondent is entitled to try to prove her claim.

Respondent's complaint does not challenge the validity of Regulation Z. The Board's authority to exclude *all* fees imposed for "exceeding a credit limit" is not at issue here. Regardless of whether the Board could or would do so, section 226.4(c)(2) limits the exclusion to unilateral acts of default. *See* 12 C.F.R. § 226.4(c)(2); 12 C.F.R. Part 226, Supp. I, Official Staff Commentary at § 226.4(c)(2)-1. Since Respondent's complaint asserts that Petitioners authorized an extension of credit, this case does not trigger the exclusions listed in the regulation. Thus, a finding that



the subject fee, although portrayed as an "over-the-limit" fee, is actually a finance charge, is required by TILA and Regulation Z.

The Board itself recognizes that a fee imposed for an authorized extension of credit is a finance charge. This recognition stems from TILA's description of an "over-the-limit" fee as one imposed for an extension of credit "in excess of the amount of credit that is authorized to be extended[.]" *See* 15 U.S.C. § 1637(c)(1)(B)(iii). In excluding certain penalty fees from the finance charge, the Board carefully carved out exceptions for those where the creditor acquiesced in the would-be act of default. *See* 12 C.F.R. Part 226, Supp. I, Official Staff Commentary at § 226.4(c)(2)-1 and (c)(3). Thus, the question here is a factual one: Did Petitioners authorize Respondent to exceed her credit limit? Resolution of this question does not test the regulation's validity.

Ultimately, the challenge to the Board's authority stems from the Petitioners' insistence upon pressing a good faith conformity defense, relying on a regulation inapplicable to Respondent's complaint. The express terms of TILA and Regulation Z render this defense irrelevant because, based on the allegations made in the complaint, Respondent does not challenge any Board regulation.

## ARGUMENT

### I. RESPONDENT'S COMPLAINT SHOULD NOT BE DISMISSED UNDER THE SIMPLIFIED PLEADING STANDARD OF RULE 8.

Before this Court is a motion to dismiss Respondent's complaint. Thus, the only question here is whether she has alleged facts that, if proved true, could entitle her to relief.

This Court has long acknowledged that the Federal Rules do not require a plaintiff "to set out in detail the facts upon which he bases his claim. To the contrary, all the Rules require is 'a short and plain statement of the claim' that will give the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests." *Conley*, 355 U.S. at 47.

> When a federal court reviews the sufficiency of a complaint, before the reception of any evidence either by affidavit or admissions, its task is necessarily a limited one. The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims.

*Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974). "Given the Federal Rules' simplified standard for pleading, '[a] court may dismiss a complaint only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations.'" *Swierkiewicz v. Sorema*, 534 U.S. 506, 514 (2002).

The complaint avers that Petitioners authorized an extension of credit to Respondent and imposed a fee for that



extension. *See* Complaint at ¶¶ 7, 8. Respondent alleges that this fee, albeit labeled an "overlimit charge assessment" fee, is a finance charge per the express language of TILA and Regulation Z. *See* Complaint at ¶¶ 31, 33. Having failed to disclose the fee as a finance charge, *see Id.* at ¶¶ 39, 40, Petitioners have violated TILA's disclosure requirements, thereby entitling Respondent to relief. *See* 15 U.S.C. § 1637(b)(4); 15 U.S.C. § 1640(a).

Petitioners respond to these allegations by arguing that Regulation Z permits creditors to exclude from the finance charge a fee for exceeding a credit limit. *See, e.g.*, Pet. Brief at 7. However, the cited regulation applies to fees imposed for unilateral acts of default, not *authorized* extensions of credit as alleged here. *See* 12 C.F.R. § 226.4(c)(2); 12 C.F.R. Part 226, Supp. I, Official Staff Commentary at § 226.4(c)(2)-1. The Government repeatedly acknowledges this fact. *See, e.g.*, Gov't Brief at 17 ("The Board's determination reflects that those fees are imposed only if the consumer violates the terms of the credit agreement."); 28 ("It is therefore reasonable to conclude that any OCL fee that is subsequently imposed is not 'incident to the extension of credit' but rather incident to the consumer's violation of the credit agreement.").

Resolution of this case rests on Respondent's ability to prove that Petitioners authorized the extension of credit for which she was charged the subject "over-the-limit" fee. Petitioners' insistence that they did not do so merely illustrates the factual dispute at issue here. Respondent's complaint may not be dismissed because she is entitled to adduce evidence in support of her claim. *See Scheuer*, 416 U.S. at 236.

## II. REGULATION Z IS NOT CHALLENGED BY A FINDING THAT THE "OVER-THE-LIMIT" FEE IMPOSED IN THIS CASE IS A FINANCE CHARGE.

The Sixth Circuit recognized that Respondent's complaint does not allege she committed a unilateral act of default that resulted in the imposition of an "over-the-limit" fee. Quite the contrary: Respondent alleges that the transaction that allowed her to exceed the original $2000 limit, *i.e.*, the extension of credit at issue here, was *authorized* by Petitioners. *See* Complaint ¶¶ 7, 8. Relying on the plain language of the statute, its consumer protection purposes, and the allegations of the complaint, the court ruled that section 226.4(c)(2) does not apply to the specific facts alleged in this case. This ruling is correct.

### A. THE EXPRESS LANGUAGE OF BOTH TILA AND REGULATION Z DEFINES "FINANCE CHARGE" TO INCLUDE FEES IMPOSED FOR *AUTHORIZED* EXTENSIONS OF CREDIT.

"[I]nterpretation of TILA and Regulation Z demands an examination of their express language[.]" *Milhollin*, 444 U.S. at 559. TILA defines a finance charge as "the sum of all charges, payable directly or indirectly by the person to whom credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit." *See* 15 U.S.C. § 1605(a). As examples, Congress cites interest, points, service charges, etc. *Id.*



Regulation Z defines finance charge in virtually identical terms:

> The finance charge is the cost of consumer credit as a dollar amount. It includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit. It does not include any charge of a type payable in a comparable cash transaction.

*See* 12 C.F.R. § 226.4(a). Again, interest, points, service charges, etc., are cited as examples of finance charges. *See* 12 C.F.R. § 226.4(b).

Regulation Z also outlines a number of fees that are not finance charges. *See* 12 C.F.R. § 226.4(c). Specifically, the regulation excludes late fees, overdraft charges, and similar unilateral acts of delinquency or default by the debtor. *See* 12 C.F.R. § 226.4(c)(2) and (3). *See also* 12 C.F.R. Part 226, Supp. I, Official Staff Commentary at § 226.4(c)(2).[1]

Considering the express language of TILA and Regulation Z, as well as the considerable deference due the Board, the Sixth Circuit recognized that Respondent's complaint asserts an *authorized extension of credit*, not a unilateral act of default, as necessary to trigger the exclusion of section 226.4(c)(2):

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1. Respondent's complaint does not challenge the Board's decision to exclude from the definition of "finance charge" fees imposed for unilateral acts of default. Since that question is not before the Court, there is no need to consider whether section 226.4(c)(2) is consistent with TILA.

> Plaintiff did not unilaterally exceed her credit limit. Rather, she requested additional credit in order to make purchases. Defendants could have declined her request. Instead, they granted it, and then charged her a $29.00 fee for doing so.

*See* Cert. Pet. App. A13. The court concluded that the exclusions of section 226.4(c)(2) simply do not apply here. This conclusion rests not on a determination that the regulation is ultra vires but on the acknowledgement that the facts as alleged here do not involve the type of unilateral default that section 226.4(c)(2) covers.

### B. THE BOARD'S AUTHORITY TO EXCLUDE ALL "OVER-THE-LIMIT" FEES FROM THE FINANCE CHARGE IS NOT AT ISSUE IN THIS CASE.

The Government frames the question presented in this case as one involving the Board's ability to classify *all* "over-the-limit" fees as "other charges" rather than as finance charges. *See* Gov't Brief at I. *See also* Pet. Brief at 26. This question is not properly before the Court. Regardless of whether the Board may impose such an all-or-nothing classification, it simply has not done so in Regulation Z.

The express language of section 226.4(c)(2) excludes from the finance charge fees imposed "for actual unanticipated late payment, for exceeding a credit limit, or for delinquency, default, or a similar occurrence." *See* 12 C.F.R. § 226.4(c)(2). Reading this section to exclude *all* fees imposed for "exceeding a credit limit" conflicts with the statutory canon *ejusdem generis*.



"Where general words follow specific words in a statutory enumeration, the general words are construed to embrace only objects similar in nature to those objects enumerated by the preceding specific words." *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 114 (2001). Here, the phrase "exceeding a credit limit" should be read to embrace limitations similar to those placed on fees imposed for "late payment," "delinquency," and "default," *i.e.*, only fees imposed for exceeding a credit limit *without* the issuer's authorization are excluded from the finance charge. Significantly, Regulation Z itself adopts this rule of construction, as section 226.4(c)(2) lists various acts of default and then "similar" occurrences. The Board's Commentary also supports this reading. *See* 12 C.F.R. Part 226, Supp. I, Official Staff Commentary at § 226.4(c)(2)-1 (where creditor acquiesces in would-be act of default, subsequent fee may be finance charge).[2]

Under this rule of construction, section 226.4(c)(2) excludes from the finance charge only fees imposed for *acts of default*. Petitioners concede as much. *See* Pet. Brief at 7 ("Although the original regulation did not expressly address "over-the-limit" fees, the Board and its staff nevertheless interpreted the regulation as excluding such fees from the finance charge on the ground that "over-the-limit" fees were a type of delinquency or default charge."). *See also* Gov't Brief at 17 ("The Board's determination [excluding "over-the-limit" fees from the finance charge] reflects that those fees are imposed only if the consumer violates the terms of the credit agreement.").

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2. This reading is the only one consistent with TILA's description of an "over-the-limit" fee as a "fee imposed in connection with an extension of credit in excess of the amount of credit *authorized to be extended* with respect to such account (emphasis added)." *See* 15 U.S.C. § 1637(c)(1)(B)(iii).

## C. THIS CASE DOES NOT INVOLVE AN ACT OF DEFAULT.

Petitioners argue that a consumer's request to make a purchase that ultimately results in her exceeding her credit limit is necessarily an act of default because creditors do not have the real-time information necessary to instantaneously approve or deny that request. *See* Pet. Brief at 15 (it is "impossible for creditors to have precise, real-time knowledge that a particular charge will cause an account to exceed its credit limit."). This argument rests on facts that were not properly before the district court on a motion to dismiss, and thus not properly before this Court, thereby underscoring the sufficiency of the legal claim alleged. Additionally, the argument is contrary to everyday experience in the present-day market.[3]

In 1980, when section 226.4(c)(2) was promulgated, real-time authorization was not nearly as wide-spread as it is today. In most circumstances, merchants manually imprinted the consumer's credit card which was then mailed to the issuer along with the specific purchase information. The consumer was gone with the goods long before the issuer even knew a request for credit had been made. Since instantaneous authorization was not economically feasible for all transactions, the issuer elected to forego a real-time option to approve or decline a specific purchase in the majority of circumstances.[4]

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3. In any event, the creditor's inability to obtain what it believes is adequate real-time information may (or may not) be a reason to decline a request for additional credit, but it says nothing about whether that authorized extension of credit is an act of default.

4. "Floor limits" were established that required the merchant to obtain pre-approval for purchases over a certain dollar amount.



Times have changed. Today, consumers can dial-up automated systems to access up-to-the-minute information about their own accounts. The consumer can obtain the balance due, available credit, and a listing of transactions since the last billing statement. Although pending charges may not be itemized in the automated system, they are nonetheless deducted from the amount of credit available once the charge has been "authorized" by the issuer.[5] Thus, the precise amount of credit available to the consumer can be obtained at any given moment in the blink of an electronic eye.

More important for present purposes, when the consumer seeks to make a purchase, this real-time information is not only readily available, but regularly used by the *creditor* to authorize the request:

> When a consumer uses a Visa card or a MasterCard card to pay for goods or services, the accepting merchant relays the transaction information to the acquiring bank with which it has contracted. The acquirer processes and packages that information and transmits it to the network (Visa U.S.A. or MasterCard). The network then relays the transaction information to the cardholder's issuing bank, which approves the transaction if the cardholder has a sufficient credit line. Approval is sent by the issuer to the acquirer, which relays it to the merchant.

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5. If pending charges are not available from the automated system, the consumer need only follow the telephone prompts to reach a customer service representative who can access the information.

*See United States v. Visa U.S.A., Inc.*, 2003 WL 22138519, *2 (2d Cir. September 17, 2003). Technological innovations have reduced this process to a mere matter of seconds, enabling issuers to review every request for credit, no matter how large or small. *Id.* at 334.

This real-time authorization process is triggered every time the consumer seeks to make a purchase, regardless of whether the requested extension falls within or beyond the credit limit.[6] Although the issuer may have contractual obligations to honor all requests up to the established limit, there is no obligation to authorize extensions that go beyond it. Since the issuer has the real-time option to approve or deny an extension that exceeds the credit limit, the consumer cannot be said to have unilaterally defaulted on her account merely by making the request. Where the issuer authorizes the extension, the consumer is not in default and any fee imposed for that credit must be disclosed as part of the finance charge.[7]

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6. On remand, Respondent intends to show that the instantaneous approval process was present in this case, namely, that Petitioners authorized the extension of credit that resulted in Respondent exceeding her credit limit.

7. Because this matter is before the Court on a motion to dismiss, the record contains no evidence with respect to the past or present operation of the credit card authorization process. On remand, Respondent is prepared to offer in evidence expert testimony of Professor James L. Brown of the University of Wisconsin-Milwaukee, former member of the Consumer Advisory Council, Board of Governors, Federal Reserve System (1979-1981). Mr. Brown is prepared to testify to each of the facts asserted here regarding the industry's authorization process.



## D. THE BOARD RECOGNIZES THAT A FEE IMPOSED FOR AN AUTHORIZED EXTENSION OF CREDIT IS A FINANCE CHARGE.

Petitioners criticize the Sixth Circuit for drawing a distinction between unilateral acts of default and authorized extensions of credit. *See, e.g.*, Pet. Brief at 11 ("Having rejected the Board's classification of over-limit fees, the court of appeals substituted a fact-dependent test of its own making."). However, this distinction is mandated by TILA's description of an "over-the-limit" fee. As the Government concedes, a fee must be imposed for credit "in excess of the amount of credit *authorized to be extended*" in order to be an over-the-limit fee. *See* Gov't Brief at 2 (quoting 15 U.S.C. § 1637(c)(1)(B)(iii)).

This fact-specific test is echoed by the Board's exclusion from the finance charge of only those acts of default in which the creditor has not acquiesced. For instance, with late fees, only those imposed for "actual unanticipated late payment" are excluded from the finance charge. *See* 12 C.F.R. § 226.4(c)(2). The Board commented that while "[l]ate payment charges *can* be excluded from the finance charge[,]" where the creditor "allow[s] the late payment without demanding payment in full or taking other action to collect[,]" the charge may be a finance charge. *See* 12 C.F.R. Part 226, Supp. I, Official Staff Commentary at § 226.4(c)(2)-1 (emphasis added). In other words, only those imposed for unilateral acts of default are excluded from the finance charge.

Similarly, overdraft fees are excluded from the finance charge unless the parties agreed to the payment of items that

overdraw the account. *See* 12 C.F.R. § 226.4(c)(3) (finance charge excludes "[c]harges imposed by a financial institution for paying items that overdraw an account, *unless* the payment of such items and the imposition of the charge were previously agreed upon in writing." (emphasis added)). Once again, where the creditor has acquiesced in what otherwise may appear to be an act of default, the fee imposed is a finance charge.

There is no reason to believe that the Board views exclusion of charges for exceeding a credit limit any differently from other would-be acts of default. In fact, the Board concedes that when "a charge denominated as an over-limit fee is in fact an expected charge for extending credit itself[,]" that charge is "an anticipated cost of the credit extension and therefore a finance charge under § 226.4(a)." *See* Pet. App. A50-A51 n.8.

Respondent's complaint specificaliy avers that Petitioners authorized an extension of credit to her and imposed a fee for doing so. *See* Complaint at ¶¶ 7, 8. Based on the allegations in this case, that fee is a finance charge and Petitioners' failure to disclose it as such is a violation of the Act. *See* 15 U.S.C. § 1637(c)(1)(B)(iii). *See also* 15 U.S.C. § 1637(b)(4); 15 U.S.C. § 1640(a).



## III. IF THIS COURT AGREES WITH RESPONDENT THAT HER COMPLAINT SURVIVES A MOTION TO DISMISS, NO BOARD REGULATION IS AT ISSUE AND, THUS, THE GOOD FAITH CONFORMITY DEFENSE IS IRRELEVANT.

The Sixth Circuit inherently recognized that resolution of this case revolves around whether the subject fee was imposed for a unilateral act of default or an authorized extension of credit. Nonetheless, rather than reversing the dismissal of Respondent's complaint and remanding the matter for litigation of the underlying factual question, the court went on to grant Petitioners a good faith conformity defense under 15 U.S.C. § 1640(f). By doing so, the court resolved a key factual issue and unnecessarily invalidated section 226.4(c)(2).

Petitioners seem to believe that as long as they characterize this finance charge as an "over-the-limit" fee, they are guaranteed to escape liability by claiming they complied in good faith with Regulation Z. *See* Pet. Brief at 6. ("creditors who act 'in good faith conformity with any rule, regulation, or interpretation thereof by the Board' are immune from civil liability, even if the rule, regulation or interpretation is later 'amended, rescinded, or determined by judicial or other authority to be invalid for any reason.'"). This belief overlooks the need to prove *actual conformity* with a regulation that authorizes Petitioners' conduct. *See, e.g., Jones v. Bill Heard Chevrolet, Inc.*, 212 F.3d 1356, 1364 (11th Cir. 2000) (citing *McGowan v. Credit Ctr., Inc.*, 546 F.2d 73, 77 (5th Cir. 1977)) (creditor must "demonstrate reliance upon [the Board's] regulations and commentaries before it can successfully invoke TILA's 'good faith' defense.").

A good faith conformity defense necessarily rests on a regulation that allows the specific act or omission that has been challenged. Since section 226.4(c)(2) does not exclude from the finance charge a fee imposed for an *authorized* extension of credit, as alleged in Respondent's complaint, Petitioners have no applicable regulation on which to rest their proposed defense.

Assuming, *arguendo*, that this case involved allegations that Respondent exceeded her credit limit *without* Petitioners' authorization, Petitioners would have no liability and the good faith conformity defense need not be reached. As discussed above, section 226.4(c)(2) and its Commentary provide that fees imposed for unilaterally exceeding a credit limit are not finance charges. *See* 12 C.F.R. § 226.4(c)(2); 12 C.F.R. Part 226, Supp. I, Official Staff Commentary at § 226.4(c)(2). Petitioners' failure to disclose as a finance charge an "over-the-limit" fee for that *unauthorized* act of default would not violate TILA's disclosure requirements per the express terms of the regulation. The factual determination of good faith conformity would only arise if a court were to invalidate a portion of the regulation (which neither side is advocating).

Here, however, Petitioners cannot cite a single provision of Regulation Z that excludes from the finance charge fees imposed for an *authorized* extension of credit that takes the consumer beyond her credit limit. To the contrary, the Board has stated that when "a charge denominated as an over-limit fee is in fact an expected charge for extending credit itself[,]" that charge is "an anticipated cost of the credit extension and therefore a finance charge under § 226.4(a)." *See* Pet. App. A50-A51 n.8. Thus, based on the allegations



of Respondent's complaint, the regulation with which Petitioners must comply requires disclosure of the fee as a finance charge.

The fact that Petitioners may have misinterpreted section 226.4(c)(2) is irrelevant. A creditor's "honest and reasonable but mistaken interpretation" of a regulation does not trigger the protection of the good faith defense. *See Hendley v. Cameron-Brown Company*, 840 F.2d 831, 834 (11th Cir. 1988) (quoting *Cox v. First Nat'l Bank of Cincinnati*, 751 F.2d 815, 825 (6th Cir. 1985)) ("Section 1640(f) 'does not protect a creditor who *fails* to conform with a regulation or interpretation through an honest, good faith mistake (emphasis in original).'"). Thus, if Respondent succeeds in proving that the extension of credit at issue was authorized by Petitioners, section 226.4(c)(2) cannot be used to shield them from liability.

Finally, as noted above, for the good faith conformity defense to be applicable, a court would necessarily have to conclude that section 226.4(c)(2) is invalid. To do so would undermine the very deference to the Board that Petitioners advance.

"This Court has held that the regulations and interpretations of the Board and its staff under TILA should be 'dispositive' unless 'demonstrably irrational.'" *See* Gov't Brief at 8-9 (quoting *Milhollin*, 444 U.S. at 565). This standard stems from Congress' desire to vest the Board with broad authority to prevent evasion of the core disclosure requirements of TILA. *See Mourning*, 411 U.S. at 371.

Here, Petitioners characterize their imposition of a finance charge as an "over-the-limit" fee hoping to avoid

proper disclosure of the true cost of the extension of credit. This is precisely the type of evasion the Board was empowered to prevent. In fact, the Board has rejected such efforts to circumvent the purposes of the Act by distinguishing fees imposed for unilateral acts of default from those tied to authorized extensions of credit. *See* 12 C.F.R. § 226.4(c)(2); 12 C.F.R. Part 226, Supp. I, Official Staff Commentary at § 226.4(c)(2)-1.

Undeniably, Respondent's complaint alleges that Petitioners *authorized* the extension of credit for which they imposed this "Overlimit charge assessment." *See* Complaint at ¶¶ 7, 8. If these allegations prove true, after submission of appropriate summary judgment evidence or a trial on the merits, Petitioners have violated TILA's disclosure requirements. *See* 15 U.S.C. § 1637(b)(4); 15 U.S.C. § 1640(a). Respondent is entitled to attempt to prove this violation.



## CONCLUSION

For the foregoing reasons, the judgment of the Sixth Circuit should be affirmed, as modified to make clear that because Respondent's complaint does not seek invalidation of section 226.4(c)(2), no good faith defense is relevant, and remanded for further proceedings on the merits.

Respectfully submitted,

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IN THE

# Supreme Court of the United States

HOUSEHOLD CREDIT SERVICES, INC. AND MBNA AMERICA BANK, N.A.,
*Petitioners,*

*v.*

SHARON R. PFENNIG,
*Respondent.*

**On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit**

## REPLY BRIEF FOR PETITIONER

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IN THE

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No. 02-857

HOUSEHOLD CREDIT SERVICES, INC.,
AND MBNA AMERICA, N.A.,
*Petitioners,*

*v.*

SHARON R. PFENNIG,
*Respondent.*

**On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit**

## REPLY BRIEF FOR PETITIONER

Respondent's brief abandons the Sixth Circuit's decision below and her own previous contentions on which that decision was based. The Sixth Circuit held that 12 C.F.R. § 226.4(c)(2), which states that "[c]harges . . . for exceeding a credit limit" are "not finance charges" under the Truth in Lending Act ("TILA"), is contrary to the statute and "cannot stand." Pet. App. A12. Respondent advanced this position below and in her opposition to certiorari. Accordingly, we showed in our opening brief that § 226.4(c)(2) was a proper exercise of the Board's delegated authority and should have been upheld by the Sixth Circuit as it was by the district court. The United States, as amicus curiae, has filed a brief supporting the Board's regulation and explaining that over-limit fees are properly treated as "other charges" under Regulation Z, rather than "finance charges." In response to these arguments and the authority

against her, respondent has changed her position. She now "does not challenge the validity of Regulation Z," and she states that "[t]he Board's authority to exclude *all* fees imposed for 'exceeding a credit limit' is not at issue here." Resp. Br. 6 (emphasis in original).

Respondent's merits brief advances, instead, a new theory that § 226.4(c)(2) should be judicially interpreted not to apply to her case. Respondent concedes that petitioners imposed over-limit fees because she engaged in transactions that exceeded the $2000 credit limit for her account. But she asks this Court to interpret Regulation Z's treatment of "[c]harges . . . for exceeding a credit limit" to be inapplicable, despite its plain language, on the ground that petitioners allowed merchants to honor her credit card in connection with the transactions that caused her account to exceed the credit limit. Respondent's new theory contradicts that portion of the Sixth Circuit's decision holding, against her, that petitioners were protected from any damages claims under TILA because they complied in good faith with the Board's regulation. The Sixth Circuit said: "Even assuming all allegations in Plaintiff's complaint are true and construing those allegations in the light most favorable to Plaintiff, it is undisputed that the fee at issue in this case was imposed for 'exceeding a credit limit'" and "unequivocally Regulation Z did not" require petitioners "to disclose this fee as a finance charge." Pet. App. A17. Respondent did not cross-petition for review of that aspect of the Sixth Circuit's decision, but she now asks this Court to modify the decision below based on her new theory of the case.

For the reasons we discuss below, respondent's current interpretation of Regulation Z should be rejected and the Board's regulation should be applied precisely as its plain text provides. Section 226.4(c)(2) states unambiguously that "[c]harges . . . for exceeding a credit limit" are "not finance charges," and the Board has confirmed that the regulation applies to over-limit fees imposed in circumstances like respondent's case.



## I. RESPONDENT'S COMPLAINT FAILS TO STATE A CLAIM BECAUSE REGULATION Z PRESCRIBES THAT THE OVER-LIMIT FEES CHARGED BY PETITIONERS HERE ARE NOT FINANCE CHARGES.

Respondent's current argument that § 226.4(c)(2) does not apply to her case is wrong for two reasons. *First*, and most important, it is not what Regulation Z says. The plain text of § 226.4(c)(2) broadly requires creditors to exclude from the finance charge any fee for exceeding the credit limit on an account. The regulation was drafted to establish a bright-line rule, as the Board has stated, and it does not depend on a transaction-by-transaction analysis of why the cardholder exceeded the credit limit on her account. Respondent's reliance on *other* provisions of Regulation Z to support her interpretation of § 226.4(c)(2) is misplaced. *See infra*, Part I.A. *Second*, respondent's complaint does not in any event allege that petitioners authorized her to exceed the credit limit on her account. Respondent contends that petitioners allowed merchants to accept her credit card for transactions, and that those transactions resulted in her account balance exceeding its credit limit. But she does not allege that she asked petitioners for permission to exceed the credit limit placed on her use of the account, or that petitioners granted any such permission to her, and any such allegation would be inconsistent with the way the in-store merchant approval process works. *See infra*, Part I.B.

### A. Regulation Z Provides That Charges For Exceeding A Credit Limit Are Not Finance Charges.

Respondent's argument is now that Regulation Z's exclusion of over-limit fees from the finance charge (12 C.F.R. § 226.4(c)(2)) is inapplicable to the fees at issue in this case. Her dispute is not about whether petitioners should have disclosed the over-limit fees at all—which petitioners undisputedly did—but about whether petitioners should have disclosed the fees as "finance charges" instead of "other charges." In adopting its regulation, the Federal Reserve

Board determined that credit-card issuers should treat *all* fees imposed for exceeding a credit limit on a uniform basis as "other charges," and it so provided in plain regulatory language. Nothing in the text of Regulation Z, or in the Board's basis for classifying such charges as "other charges" rather than "finance charges," suggests that this classification should turn on the reasons that the cardholder exceeded the credit limit, or on whether a merchant received an okay to accept the credit card for a transaction resulting in the cardholder's account exceeding its credit limit. Respondent's argument that § 226.4(c)(2) does not apply to her case is erroneous.

### 1. Plain language.

The text of § 226.4(c)(2) provides as follows:

**§ 226.4 Finance charge.**

. . .

(c) *Charges excluded from the finance charge.* The following charges are not finance charges:

. . .

(2) Charges for actual unanticipated late payment, for exceeding a credit limit, or for delinquency, default, or a similar occurrence.

Respondent concedes that petitioners imposed over-limit fees because she exceeded the $2000 credit limit on her account. *See, e.g.*, Resp. Br. 7; Pet. App. A39 (Complaint ¶ A34). The words of § 226.4(c)(2) cover such fees, but respondent asks this Court to construe the regulation to limit the exclusion for over-limit fees to situations where the cardholder has engaged in what she calls a "unilateral act[] of default." *E.g.*, Resp. Br. 6. The exact contours of respondent's position are uncertain, and the phrase "unilateral act of default" is not found in Regulation Z or TILA.

Respondent's reading contradicts the text of the regulation. Section 226.4(c)(2) states an unambiguous, bright-line rule that uniformly excludes from the "finance charge" all "[c]harges ... for exceeding a credit limit,"



regardless of whether the cardholder's act of exceeding the credit limit is or is not a "unilateral act of default." In this way, over-limit charges are uniformly treated as "other charges," rather than (as respondent would have it) sometimes as "finance charges" and sometimes as "other charges." The regulation makes no reference to the limitations respondent would read into it. There is no reason to read into the regulation exceptions that the Board, in its multiple rounds of rulemaking (*see* Pet. Br. 8), did not choose to include.

### 2. Textual construction.

Lacking express support in the regulation, respondent seeks implicit support in other charges (besides over-limit fees) that are excluded from the finance charge calculation by § 226.4(c)(2) and in the *ejusdem generis* canon of statutory interpretation. But that canon is simply inapplicable. The words to be interpreted here ("exceeding a credit limit") are not "general words [that] follow specific words in a statutory enumeration." *Circuit City Stores, Inc.* v. *Adams*, 532 U.S. 105, 114 (2001) (internal quotation marks omitted). Rather, the phrase "exceeding a credit limit" describes charges that § 226.4(c)(2) quite *specifically* excludes from the finance charge.[1]

Furthermore, "[c]anons of construction need not be conclusive and are often countered ... by some maxim pointing in a different direction." *Circuit City*, 532 U.S. at 115. In *Circuit City*, the Court employed the *ejusdem generis* canon because the alternative interpretation of the residual phrase of the statute at issue would have left portions of the statute without independent meaning. *See id.* at 114. Here, it is respondent's interpretation that would render part of the regulation superfluous. *See, e.g.*, *TRW Inc.* v. *Andrews*, 534 U.S. 19, 31 (2001) ("It is a cardinal

[1] Moreover, as respondent herself concedes (Br. 13), the phrase "exceeding a credit limit" *precedes* the only general words in § 226.4(c)(2), the residual phrase "or a similar occurrence."

principle of statutory construction that a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant." (Internal quotation marks omitted)). Respondent's contention that the regulatory phrase "exceeding a credit limit" should be limited to "unilateral acts of default" would rob the over-limit clause of independent meaning, because § 226.4(c)(2) provides *separately* that charges for customer "default" are not finance charges. A charge for exceeding a credit limit that results from a unilateral act of default is thus already excluded from the "finance charge" by § 226.4(c)(2)'s reference to "default" charges.

Respondent also errs when she argues by comparison to Regulation Z's separate exclusions from the "finance charge" for "*actual unanticipated* late payment" charges (in § 226.4(c)(2) (emphasis added)) and checking-account charges "for paying items that overdraw an account, *unless the payment of such items and the imposition of the charge were previously agreed upon in writing*" (in § 226.4(c)(3) (emphasis added)). *See* Resp. Br. 17-18. Her basic error is that the particular language upon which she relies in the § 226.4(c)(2) late-payment and § 226.4(c)(3) overdraft exclusions—italicized above—is conspicuously *absent* from the § 226.4(c)(2) over-limit exclusion. In these circumstances, the appropriate inference is not that the over-limit exclusion should be interpreted similarly to the late-payment and overdraft exclusions, but rather that the special limiting words were meant to apply only in the exclusions in which they were used. *See Barnhart* v. *Sigmon Coal Co.*, 534 U.S. 438, 452 (2002) ("[I]t is a general principle of statutory construction that when Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." (Internal quotation marks omitted)).

Turning more specifically to § 226.4(c)(2), respondent is wrong to uproot the phrase "actual unanticipated" from the late-payment exclusion and try to transplant it into the over-limit exclusion. *See* Resp. Br. 17. Section 226.4(c)(2) has three principal clauses, each distinct from the others, and each separately introduced by the word "for." *See* 12 C.F.R. § 226.4(c)(2) ("The following charges are not finance charges: . . . [c]harges *for* actual unanticipated late payment, *for* exceeding a credit limit, or *for* delinquency, default, or a similar occurrence." (emphases added)). Under standard interpretive principles, the use of the "actual unanticipated" modifier in the "late payment" exclusion, combined with its absence from the immediately following "exceeding a credit limit" exclusion, shows that the Board consciously intended the latter exclusion to be free from such a qualification.[2]

The history of the administrative process leading to the promulgation of § 226.4(c)(2) confirms this point. When the Board first proposed in 1980 to include an express reference to over-limit fees in § 226.4, the initial version of the proposed regulation arguably included "actual, unanticipated" as a modifier for all of the categories included in its list. *See* 45 Fed. Reg. 29702, 29735 (May 5, 1980) (excluding from the finance charge "[a] charge for actual, unanticipated late payment, exceeding a credit limit, delinquency, default, or similar occurrence"). The Board, however, revised this proposed language to make clear that the phrase "actual, unanticipated" would apply only to late-payment fees and to underscore that the three separate categories of charges listed in the regulation should be read separately. *See* 45 Fed. Reg. 80648, 80697 (Dec. 5, 1980) (excluding "[a] charge *for* actual, unanticipated late payment, *for* exceeding a credit limit, and *for* delinquency, default, or similar occurrence" (emphases added)). The final version of the regulation—

[2] Respondent's brief also relies on the Official Staff Commentary to § 226.4(c)(2). *See, e.g.*, Resp. Br. 13, 17 (citing 12 C.F.R. Part 226, Supp. I, § 226.4(c)(2)-1, *Late payment charges*). But the commentary itself undermines respondent's construction of § 226.4(c)(2). The discussion cited by respondent explains factors relevant to the determination of whether a charge is for "actual unanticipated" late payment and, as its heading states, pertains *only* to "late payment charges."

which was moved to § 226.4(c)(2)—retained this important clarification. *See* 46 Fed. Reg. 20848, 20894 (Apr. 7, 1981); 12 C.F.R. § 226.4(c)(2).

Respondent's invocation of § 226.4(c)(3) is similarly misplaced. That subsection provides that "[c]harges imposed by a financial institution for paying items that overdraw an account" are not finance charges "unless the payment of such items and the imposition of the charge were previously agreed upon in writing." Respondent seeks to read this subsection's "unless" clause into § 226.4(c)(2) as well, arguing that "where the creditor has acquiesced in what otherwise may appear to be an act of default, the fee imposed is a finance charge." Resp. Br. 18. But respondent's argument is again contrary to accepted principles of textual interpretation. What the presence of the "unless" clause in § 226.4(c)(3)—and its absence from the immediately preceding over-limit exclusion of § 226.4(c)(2)—demonstrates is precisely that the over-limit exclusion is *not* subject to the same qualification. *See supra*, p.6 (citing *Barnhart*, 534 U.S. at 452). Moreover, even reading the "unless ... previously agreed upon in writing" phrase into the over-limit clause of § 226.4(c)(2) would not support respondent's argument: respondent does not (and could not in good faith) allege that she and petitioners ever agreed in writing to permit respondent to exceed her $2000 credit limit.[3]

### 3. Board interpretation and regulatory purpose.

Respondent recognizes that the Board's interpretation of its own regulation is important and accordingly contends

[3] Section 226.4(c)(3)'s distinction between written and oral agreements to pay checking-account overdrafts demonstrates the Board's use of bright-line rules in defining charges to be included and excluded from the finance charge under TILA. Even when a bank and the holder of a checking account have reached an explicit oral agreement that the bank will pay any future overdrafts, § 226.4(c)(3) excludes fees imposed in connection with such payments from the finance charge.



that the Board agrees with her construction of § 226.4(c)(2). But it does not. Indeed, the Government has filed a brief in this case supporting petitioners and arguing that the judgment of the court of appeals should be reversed. As that brief explains, the Board interprets § 226.4(c)(2) as "adopt[ing] a categorical approach that treats all [over-limit] fees" in the same manner, excluding such fees from the finance charge and instead classifying them as "other charges." U.S. Br. 28; *see also id.* at 22, 27-29. Unless "demonstrably irrational," that interpretation should be dispositive. *See Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 565 (1980); *cf. Thomas Jefferson Univ.* v. *Shalala*, 512 U.S. 504, 512 (1994) (holding that an agency's interpretation of its own regulation is entitled to deference).

The Board's interpretation of its own regulation is consistent not only with the plain text of § 226.4(c)(2), but also, as the Government's brief emphasizes, with the purposes of TILA. Congress enacted TILA in 1968 "to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit ...." 15 U.S.C. § 1601(a). Approximately a decade later, Congress found that TILA's goals had been ill-served because consumers received disclosures that were lengthy and complex and creditors found it increasingly difficult to comply with the steady stream of complicated administrative and judicial interpretations of the statute. *See* S. Rep. No. 96-73, at 2 (1979), *reprinted in* 1980 U.S.C.C.A.N. 280, 281). Congress therefore amended TILA in 1980, with passage of the Truth in Lending Simplification and Reform Act, "to provide the consumer with clearer credit information" and to "make creditor compliance easier." *Id.*, 1980 U.S.C.C.A.N. at 280. As we showed in our opening brief, and the United States explains in its brief, § 226.4(c)(2) serves the purposes of the amended TILA statute *because* it simply and uniformly excludes all over-limit fees as a class from the finance charge. *See* Pet. Br. 25-29; U.S. Br. 16-19, 26-29. This bright-line rule ensures that creditors disclose over-limit fees in an understandable and consistent manner,

permitting consumers to compare such fees across time and across credit-card issuers in a meaningful way. Further, as a uniform exclusion of all over-limit fees from the finance charge, the regulation provides issuers with a straightforward, easily-applied standard.

Respondent advances no reason to believe that her construction of § 226.4(c)(2) would serve TILA's purposes or be consistent with the Board's goals in promulgating its 1981 amendments to Regulation Z. Contrary to Congress's goal of "mak[ing] creditor compliance easier" (S. Rep. No. 96-73, at 2, 1980 U.S.C.C.A.N. at 280) and the Board's stated purpose of amending Regulation Z to "substitute[], where possible, precise, easily-applied rules for principles that create ambiguity and require additional regulatory clarification" (45 Fed. Reg. 80648, 80648 (Dec. 5, 1980)), respondent asks this Court to adopt a construction of § 226.4(c)(2) that would impose a requirement on creditors that is not stated anywhere in the text of Regulation Z. An interpretation that contradicts the plain text of the regulation cannot square with the mandate for "precise, easily-applied" rules.

Because TILA subjects creditors who violate its requirements to potentially significant monetary damages (*see* 15 U.S.C. § 1640(a)), respondent's rule would also be an inappropriately expensive one for creditors, penalizing them for failing to divine an unstated exception to the regulation that is contrary to its express terms. As the United States explains in its brief, "[w]ith the costs of misclassification so high, ... the Board rationally adopted a simple rule that classifies all [over-limit] fees as 'other charges,' and, at the same time, requires disclosure of those fees in every case." U.S. Br. 27. To ensure consistency with the purposes of TILA, and with the Board's stated purposes in amending Regulation Z, § 226.4(c)(2) should be interpreted just as its plain text reads, excluding all "[c]harges ... for exceeding a credit limit" from the finance charge.



### 4. TILA solicitation and application provisions.

Respondent's last argument for her current interpretation of § 226.4(c)(2) is based on TILA's statutory provisions governing credit and charge card solicitations and applications, 15 U.S.C. § 1637(c)(1)(B)(iii) and (c)(4)(B)(iii). *See* Resp. Br. 13 n.2, 17. These provisions require certain solicitations and applications to disclose "[a]ny fee imposed in connection with an extension of credit in excess of the amount of credit authorized to be extended with respect to such account." We showed in our opening brief that Congress's requirement of these disclosures of over-limit fees in connection with charge cards—which by statutory definition involve credit not subject to "finance charges"—supports the Board's regulatory position that over-limit fees are not "finance charges." *See* Pet. Br. 22-23. Respondent does not answer that argument.

Instead, seizing on the use of the word "authorized" in § 1637(c)(1)(B)(iii) and (c)(4)(B)(iii), respondent reads those statutory provisions as defining "[o]ver-the-limit fee" to exclude charges that are imposed for exceeding a credit limit whenever the card issuer has allowed the merchant to honor the credit card in connection with the relevant transaction. There are many problems with this argument, beginning with the point that nothing in § 1637(c) places any limit, as a logical or textual matter, on the Board's discretion to exclude fees from the "finance charge" to be disclosed under TILA and Regulation Z.

More important, respondent misunderstands what these provisions say. The word "authorized" is used in §§ 1637(c)(1)(B)(iii) and (c)(4)(B)(iii) in the phrase "the amount of credit authorized to be extended with respect to such account." That phrase describes the "limit" in an "[o]ver-the-limit" fee. When the statute refers to "the amount of credit authorized to be extended with respect to such account," it means the amount of debt the card issuer has pre-authorized the cardholder to incur on her account. It does not refer to a communication from the card issuer

okaying or "authorizing" a merchant to accept a credit card as payment for a particular transaction.[4] The statute is therefore of no assistance to respondent, who does not (and could not) allege that petitioners raised her credit limit. On the contrary, she acknowledges that "[a] 'credit limit' represents the amount of credit the card issuer has *pre-approved* the consumer to obtain" on the account, and that this case concerns "an extension of credit that took Respondent beyond the stated $2000 credit limit" applicable to her account. Resp. Br. 1 (emphasis added). The over-limit fee in this case was (to use the words of the statute) "imposed in connection with an extension of credit in excess of the amount of credit authorized to be extended with respect to such account" because (to use respondent's words) she made charges on her account "beyond the $2000 credit limit." Nothing in these sections of TILA indicates anything different.[5]

### B. Respondent Does Not Allege That Petitioners Authorized Her To Exceed Her Credit Limit.

There is an additional problem with respondent's current argument: she has not pleaded (and cannot plead) that she ever obtained authorization from petitioners to exceed the credit limit applicable to her account. Respondent does not claim that she asked for a credit-line increase (or that one was given without her asking). Nor does she

[4] We discuss *infra* at pp.13-14 & n.6, the contractual nature of a card issuer's "authorization" to a merchant to honor a credit card.

[5] The Board's interpretation of § 1637(c)(1)(B)(iii) and 1637(c)(4)(B)(iii) accords with our reading of the statute. The Board has interpreted the phrase "the amount of credit authorized to be extended with respect to such account" in those provisions as signifying the *credit limit* on a cardholder's account. The regulation, 12 C.F.R. § 226.5a(b)(10), refers to an "over-the-limit fee" as "[a]ny fee imposed for exceeding a credit limit." Section 226.5a(b)(10) parallels, and is fully consistent with, the regulation at issue in this case, § 226.4(c)(2). These interpretations are of course entitled to deference. *See* Pet. Br. 18-21; Resp. Br. 11, 21; *see also* U.S. Br. 12-14.



claim that she contacted petitioners and obtained their authority to exceed the credit limit on her account in connection with any individual transaction.

On the contrary, when respondent's briefs assert that her over-limit transactions were "authorized," she is referring to the fact that the merchants with whom she transacted business may have obtained an okay or "authorization" from the credit-card network (indirectly from a credit-card issuer) to accept respondent's credit card as payment for a transaction. *See* Brief for Appellant in the Sixth Circuit at 14 ("As anyone who has ever used a credit card to make a purchase knows, the merchant submits the charge for 'approval' by the credit card issuing bank before the charge can proceed. The credit card issuing bank gets to make the decision as to whether or not that charge will be permitted to go through."); *see also* Resp. Br. 14-16. Pursuant to separate agreements they have with their acquiring banks, merchants normally must seek "authorization" for credit-card charges through point-of-sale systems or else bear the risk of loss should the cardholder ultimately fail to pay the credit-card issuer because the charge was fraudulent or for other reasons.[6] These merchant agree-

[6] When a merchant accepts a bank credit card from a consumer as consideration for a transaction, the merchant obtains payment by submitting the transaction information to its bank (known as the merchant bank or the acquiring bank), which credits the merchant's account in the amount of the charge minus a fee. The merchant bank then submits the transaction information to the relevant credit-card system (e.g., Visa, MasterCard, etc.), which in turn relays the information to the credit-card issuing bank. The issuing bank then pays the merchant bank the amount requested minus an interchange fee. The issuing bank posts the charge to the consumer's account and collects payment from the consumer. *See generally United States* v. *Visa U.S.A., Inc.*, 344 F.3d 229, 235 (2d Cir. 2003); *National Bancard Corp.* v. *Visa U.S.A., Inc.*, 779 F.2d 592, 594 (11th Cir. 1986); 2 Lary Lawrence & Bryan Hull, *Payment Systems* § 17:2 (2002).

In a number of circumstances, a "chargeback" may be assessed to the merchant in connection with (and in the amount of) a particular transaction, thereby shifting the costs of a transaction back onto the

ments and the "authorization" provisions thereunder are entirely separate and distinct from the credit-card lending agreements between card issuers and cardholders, and have no legal relationship with the credit limit that the credit-card agreements make applicable to consumers' uses of their accounts.

Thus, as the Government has explained, § 226.4(c)(2) applies when a fee is charged to the cardholder for having exceeded the credit limit on her account, without regard to whether a merchant obtains "authorization" from the credit-card issuer to accept the card for a particular transaction. The Board framed Regulation Z based on its expert understanding of the credit-card industry. Whether an account is over limit is a matter between the issuer and the cardholder, and there is no basis for interpreting a payment-system "authorization," given to a *merchant* who is not a party to the cardholder's agreement, as an authorization to the cardholder to exceed the credit limit.[7] The Govern-

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merchant. Merchant agreements normally provide that a chargeback may be assessed if the merchant fails to seek "authorization" for a credit-card charge in the amount of the charge and in accordance with the system's specifications or accepts a credit card as payment despite receiving a denial of "authorization." *See, e.g.*, 2 Barkley Clark & Barbara Clark, *The Law of Bank Deposits, Collections and Credit Cards* ¶ 15.02[4][b][i] (rev. ed. 2003) (describing the "merchant-merchant bank agreement"); Randy Gainer, *Allocating the Risk of Loss for Bank Card Fraud on the Internet*, 15 J. Marshall J. Computer & Info. L. 39, 46 (1996) ("If a merchant accepts bank card data for a sale without following the authorization procedures required by Visa or MasterCard and by the merchant's bank, only then does a merchant incur losses for accepting the fraudulent charge."); 2 Lawrence & Hull, *supra*, § 17:100; 1 Jacob W. Reby & James A. Douglas, *Banking & Lending Institution Forms: With Commentary & Checklists*, Form 5D.5 § 2.06(a), at 5D-16 (1992 & 1997 Supp.) (form bank card merchant agreement). *See generally* Brief for the American Bankers Ass'n et al. at 24-25.

[7] The Board has long recognized the difference between a request for an increased credit limit and the submission of a charge through the merchant point-of-sale authorization system. For example, Regulation B, which implements the Equal Credit Opportunity Act, distinguishes between a creditor's decision whether "to increase the amount of credit



ment's brief explains that there are numerous real-world reasons why this is sensible in fact, not the least of which is that credit-card issuers generally cannot determine with certainty, at the time they must decide whether to allow a merchant to accept a card, whether a particular charge will cause the corresponding credit-card account to exceed its credit limit and incur an over-limit fee. *See* U.S. Br. 20-22; *see also* Pet. Br. 13-16, 28-29; Brief for the American Bankers Ass'n *et al.* 24-25.

Respondent seeks to dismiss the Board's understanding of the real-world operation of credit-card systems, asserting that it consists of "facts that were not properly before the district court on a motion to dismiss, and thus are not properly before this Court," and she proposes to submit contrary expert testimony on remand. Resp. Br. 14-16. But respondent's claim to a superior insight about the credit-card industry is irrelevant. The regulation at issue in this case was promulgated by, and is properly interpreted and applied by, the Board. The Board's understanding of credit-card systems is therefore what is fundamental to the legal question of what its regulation means. The Government's brief explains that, because the point-of-sale authorization systems are not, in the Board's view, suited to identifying over-limit circumstances, "the Board has never placed any significance on what the merchant authorization process might indicate about the possibility that an [over-limit] fee will later be imposed. Instead, the Board rationally characterizes *all* [over-limit] fees as charges for violating the credit agreement rather than finance charges." U.S. Br. 22 (emphasis in original).

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available to an applicant who has made an application for an increase," 12 C.F.R. § 202.2(c)(1)(iii), and a decision whether "to authorize an account transaction at a point of sale." 12 C.F.R. § 202.2(c)(2)(iii).

## II. RESPONDENT'S CURRENT ARGUMENT IS AT ODDS WITH HER POSITION BELOW, AND HER REQUEST FOR MODIFICATION OF THE JUDGMENT IS IMPROPER.

Respondent failed to cross-petition for certiorari on the portion of the judgment below on which she lost. In the Sixth Circuit, respondent's position was that "Regulation Z flatly contradicts the plain language of TILA." Brief of Appellant in the Sixth Circuit at 12. Agreeing with respondent, the Sixth Circuit reversed in part and affirmed in part the district court's judgment dismissing respondent's complaint for failure to state a claim. *See* Pet. App. A19. The Sixth Circuit agreed with *respondent's* argument that § 226.4(c)(2) conflicts with TILA (*see* Pet. App. A12), but the court also held in *petitioners'* favor that their good-faith compliance with § 226.4(c)(2) entitled them to immunity from civil liability under 15 U.S.C. § 1640(f). *See* Pet. App. A18-A19. In support of the latter holding, the Sixth Circuit found that, "[e]ven assuming all allegations in [respondent's] complaint are true and construing those allegations in the light most favorable to [respondent], it is undisputed that the fee at issue in this case was imposed for 'exceeding a credit limit.'" Pet. App. A17. The Sixth Circuit further held that, "even if the statute required [petitioners] to disclose this fee as a finance charge, unequivocally Regulation Z did not." *Id.* (emphasis added). Based on these conclusions, the Sixth Circuit affirmed the dismissal of respondent's monetary damages claim, holding that "it is beyond cavil that [petitioners] complied with Regulation Z and pursuant to 15 U.S.C. § 1640(f) should be afforded immunity from civil damages." *Id.* at A18 n.6.[8]

Respondent did not cross-petition, conditionally or otherwise, for a writ of certiorari to review the part of the Sixth Circuit's judgment that affirmed dismissal of her

[8] Respondent's statement that the Sixth Circuit "ruled that section 226.4(c)(2) does not apply to the specific facts alleged in this case" is false. Resp. Br. 10.



claims for monetary damages. Yet respondent now argues, directly contrary to the portion of the judgment below on which she lost, that petitioners did not comply with TILA because § 226.4(c)(2) does not apply to petitioners' over-limit fees. While this Court has held that "[a] prevailing party need not cross-petition to defend a judgment on any ground properly raised below," that is true only "so long as that party seeks to preserve, and not to change, the judgment." *Northwest Airlines, Inc.* v. *County of Kent*, 510 U.S. 355, 364 (1994). If the respondent "seeks to alter the judgment below," it must file a cross-petition. *Id.*; *see also Granfinanciera, S.A.* v. *Nordberg*, 492 U.S. 33, 38-39 (1989).

Respondent has also completely changed her position from her brief in opposition to certiorari. In that brief, respondent agreed that the only question presented in this case was whether the Board's "regulation conflicts with . . . the statute," and argued that "the unambiguous language of [the] statute controls over any conflicting regulation." Resp. Br. Opp. 1.[9] Now, of course, respondent concedes that the regulation is valid and instead seeks to advance a newly-invented theory of what the regulation means. Thus, not only has respondent led the Sixth Circuit into error and then completely repudiated its opinion, she has also doubled back on the position she advanced in this Court nine months ago. Under Rule 15.2 of this Court, respondent's failure to raise her regulatory argument until her merits brief is sufficient grounds for the Court to consider the argument waived. *See also Knowles* v. *Iowa*, 525 U.S. 113, 116 n.2 (1998).

[9] Respondent's brief opposing certiorari agreed with the question presented by the petition, restating it slightly in the body of her brief as "whether a reviewing court is bound to defer to a regulation of the Federal Reserve Board interpreting [TILA] when that regulation conflicts with an unambiguous provision of the statute." Resp. Br. Opp. 1. Respondent did not identify any other questions presented in this case, nor did she argue that resolution of the statutory question could be avoided in any way.

At the conclusion of her merits brief, respondent compounds these errors by asking the Court to "modif[y]" (in reality, reverse) that portion of the Sixth Circuit's judgment against her. Resp. Br. 23. Her brief acknowledges that the Sixth Circuit held that petitioners are immune from monetary damages under TILA because they complied in good faith with Regulation Z (*see id.* at 19), but she then argues that the holding was erroneous and specifically asks this Court to "modif[y]" the judgment of the Sixth Circuit "to make clear that . . . no good faith defense is relevant." *Id.* at 23. It is well established that the respondent cannot seek to alter any part of the judgment below because she did not cross-petition for certiorari. *See Northwest Airlines*, 510 U.S. at 364. Respondent's request for "modification" of the judgment is therefore improper and should be rejected.

## CONCLUSION

The judgment of the Sixth Circuit should be reversed, and the district court's decision dismissing respondent's complaint for failure to state a claim should be reinstated.



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NOVEMBER 2003

No. 02-857

# In The Supreme Court of the United States

HOUSEHOLD CREDIT SERVICES, INC.
AND MBNA AMERICA BANK, N.A.,

*Petitioners,*

v.

SHARON R. PFENNIG,

*Respondent.*

**On Writ Of Certiorari**
**To The United States Court Of Appeals**
**For The Sixth Circuit**

## BRIEF FOR THE AMERICAN BANKERS ASSOCIATION, AMERICAN FINANCIAL SERVICES ASSOCIATION, CONSUMER BANKERS ASSOCIATION, MASTERCARD INTERNATIONAL INC., AND VISA U.S.A. INC. AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS


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## QUESTION PRESENTED

Whether the court of appeals erred in refusing to defer to the Federal Reserve Board's duly promulgated and longstanding regulation under the Truth in Lending Act, 15 U.S.C. § 1601 *et seq.*, that classifies a fee for exceeding a credit limit as not part of the "finance charge."

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## INTEREST OF *AMICI CURIAE*[1]

This case involves the validity of a regulation of the Board of Governors of the Federal Reserve System (Board or Federal Reserve Board) promulgated pursuant to its authority to effectuate the purposes of the Truth in Lending Act (TILA), 15 U.S.C. § 1601 *et seq.* The regulation provides that an over-the-limit fee (*i.e.,* a fee charged by a creditor, such as a credit card issuer, to a consumer who exceeds the credit limit applicable to his credit account) is not part of the "finance charge." 12 C.F.R. § 226.4(c)(2). Rather, the regulation requires the disclosure of an over-the-limit fee on periodic statements as an "other charge." 12 C.F.R. § 226.7(h). Respondent brought the instant action against two credit card issuers claiming that their adherence to the Board's regulation and consequent disclosure on her billing statements of an over-the-limit fee as an "other charge," rather than as part of the "finance charge," violated TILA.

*Amici* include associations whose members issue credit cards and establish other credit accounts that are subject to the requirements of the Board's regulation. The American Bankers Association is the principal national trade association of the banking industry in the United States, representing approximately 90 percent of the domestic assets of United States banks. The Consumer

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[1] Letters from the parties consenting to the filing of this brief are being filed with the Clerk along with this brief, as required under Rule 37.3(a). Pursuant to Rule 37.6, *amici* state that counsel for the parties did not author this brief in whole or in part, and no one other than the *amici*, their members, or their counsel, made a monetary contribution to the preparation or submission of this brief.

Bankers Association represents most of the nation's largest bank holding companies, institutions holding two-thirds of the industry's total assets. Its member institutions are leaders in the provision of consumer finance, including credit cards. The American Financial Services Association is a nationwide trade association that represents approximately 360 companies operating more than 10,000 offices engaged in the extension of consumer credit throughout the United States. MasterCard International Incorporated is a global membership organization comprised of financial institutions that are licensed to use the MasterCard service marks in connection with a variety of payment systems, including credit card programs. Visa U.S.A. Inc. is part of a worldwide association of more than 21,000 financial institutions that individually offer Visa-brand payment services, including Visa-brand credit cards.

*Amici* have a strong interest in the Court's upholding the validity of the Board's regulation and thereby avoiding the customer confusion and the creditor uncertainty and liability that would otherwise result. The court of appeals' ruling requires disclosure of an over-the-limit fee as a finance charge in "those instances in which the creditor knowingly permits the credit card holder to exceed his or her credit limit and then imposes a fee incident to the extension of that credit." Pet. App. A15 n.5. Imposition of that "knowingly" standard would create extraordinary difficulties for *amici* and their members. The authorization process for credit transactions does not allow credit card issuers to know with any degree of certainty, at the time of a transaction, whether a particular transaction will cause the account to exceed the applicable credit limit. Nor can credit card issuers simply treat all over-the-limit fees as part of the "finance charge" because the court of



appeals expressly recognized that the Board's regulation validly classifies over-the-limit fees that are not "knowingly" imposed as not part of the finance charge. Under such circumstances, disclosure of "other charges" as part of the "finance charge" could violate TILA. Accordingly, *amici* submit this brief based on their long and substantial experience in dealing with the regulations at issue to demonstrate that the court of appeals' ruling should be reversed.

## SUMMARY OF ARGUMENT

The court of appeals erred in rejecting the Federal Reserve Board's regulation that classifies over-the-limit fees as not part of the "finance charge" under the Truth in Lending Act (TILA) and substituting in its place a standard that is certain to destroy uniformity of disclosure and create customer confusion. TILA imposes on credit card issuers an extensive series of disclosure obligations relating to the fees and charges imposed as an incident to, as a part of, or in connection with, credit plans. These uniform disclosure obligations are designed to help consumers compare the cost of credit under different credit offerings. In particular, TILA requires that lenders who extend credit to consumers explain the costs of their credit by disclosing the applicable "finance charge" and an annual percentage rate (APR) based on the finance charge, and also inform the consumer about "other charges" imposed as part of a credit plan. 15 U.S.C. § 1637.

A. In enacting TILA, Congress recognized the difficulty of conveying complex credit information to customers in a comprehensible manner. It "determined to lay the structure of the Act broadly and to entrust its

construction to an agency with the necessary experience and resources to monitor its operation." *Mourning v. Family Publications Serv., Inc.*, 411 U.S. 356, 365 (1973). Congress selected the Federal Reserve Board, an agency well-versed in banking transactions, to exercise authority to issue regulations. Pursuant to that authority, the Board promulgated Regulation Z, 12 C.F.R. Part 226, including a provision that classifies an over-the-limit fee as not part of the finance charge, 12 C.F.R. § 226.4(c)(2).

This Court recognized in *Mourning* and *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555 (1980), the exceptionally broad authority that Congress expressly vested in the Federal Reserve Board under TILA, including explicit authority to fill gaps in the statute through its Regulation Z, and held that even an interpretation by the Board's staff is controlling unless "demonstrably irrational" *Id.* at 565. Subsequently, this Court has reaffirmed the high degree of deference due an agency, like the Federal Reserve Board, that is vested by Congress with explicit regulatory authority greater than that typically granted by Congress. The Court has held that, in such instances, the agency's duly promulgated regulation is "binding in the courts" unless "manifestly contrary to the statute," thus according it a higher degree of deference than that accorded regulatory action under the more common *Chevron* standard. *See United States v. Mead Corp.*, 533 U.S. 218, 227 (2001); *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984).

Congress granted the Federal Reserve Board explicit authority to fill statutory gaps regarding whether particular fees and charges are part of the "finance charge" or are "other charges." In Section 1604(a) of TILA, Congress granted the Board express authority to make



"classifications," "differentiations," and "exceptions" in a manner that the Board, in its judgment, deems proper to effectuate the statutory purpose or facilitate compliance. In enacting the Truth in Lending Act Amendments of 1995, Congress confirmed that TILA grants to the Federal Reserve Board the authority to promulgate regulations classifying whether certain fees and charges are part of the "finance charge" and to except fees and charges therefrom. Other provisions of TILA bear on that authority by, for example, requiring disclosure of "other charges" and leaving it to the Board to determine the contours of such charges. 15 U.S.C. § 1637(a)(5).

B. The Board's duly promulgated regulation classifying over-the-limit fees as not part of the finance charge is neither manifestly contrary to TILA nor demonstrably irrational and thus is controlling.

TILA defines "finance charge" as the "sum of all charges" that are "imposed * * * as an incident to the extension of credit." 15 U.S.C. § 1605(a). That definition does not, by its terms, require that over-the-limit fees be classified as part of the finance charge. Moreover, by listing examples of fees both within and outside the "finance charge," the structure of the definitional provision itself demonstrates that Congress did not expect the general language of the definition to clearly resolve the question whether various fees and charges are, in fact, imposed "as an incident to the extension of credit" and, thus, constitute part of the "finance charge."

Furthermore, other provisions of TILA strongly indicate that the general definition of "finance charge" was not intended to require that over-the-limit fees be included as part of that charge. As noted above, Section 1637(a)(5)

requires disclosure of "other charges which may be imposed as part of the plan." Also, Section 1637(c), explicitly recognizes that credit obtained under a charge card may be subject to an "over-the-limit" fee, even though "charge card" is defined to mean a card which is not subject to a finance charge. Section 1637(c) also labels over-the-limit fees as "other information" and describes such fees as being imposed "in connection" with an extension of credit, rather than the narrower "as an incident to" language used in the finance charge definition. In view of these many features of TILA's text and structure, it cannot be said that Section 1605(a) unambiguously includes over-the-limit fees as part of the finance charge. For these reasons, the statutory definition of "finance charge" is ambiguous and the Board's regulation is not manifestly contrary to the statute.

The Federal Reserve Board's regulation at issue here was lawfully promulgated and is not demonstrably irrational. The regulation was promulgated pursuant to formal notice-and-comment rulemaking, 5 U.S.C. § 553, as part of the Board's complete revision of Regulation Z in 1981. The Board's decision to require disclosure of over-the-limit fees not as part of the finance charge is plainly rational given the varied circumstances in which they arise and is a classic example of the Board filling a statutory gap by making classifications to effectuate the purposes of TILA.

The court of appeals' contrary approach introduces an issue of "knowingly" into the determination whether an over-the-limit fee is part of the finance charge. But mandating such a case-by-case determination would mean that an over-the-limit fee sometimes would be classified as part of the "finance charge" and included in the APR on a



consumer's periodic billing statement, but at other times would be classified as an "other charge" and not included in the APR. Such results are contrary to the clear and predictable disclosures Congress intended. Moreover, as a practical matter, the existing authorization systems used by credit card issuers and merchants cannot, and are not designed to, determine whether a particular charge, at a given time, will cause an account to exceed its credit limit. Indeed, in promulgating its 1981 revisions to Regulation Z that are at issue here, the Board rejected basing disclosure requirements on the understanding of individual parties and, instead, relied on the obligations to which consumers can be legally bound.

Finally, the Board's determination that an over-the-limit fee should not be disclosed as part of the finance charge rationally furthers the interests of consumers. The Board classifies such a fee as an "other charge" that must be separately disclosed, which means that the nature and amount of an over-the-limit fee is highlighted for the consumer on his periodic billing statement and can be easily compared to similar fees under other credit offers or plans. Treating such a fee as a finance charge, by contrast, would distort the APR, which is based on the finance charge, for the billing cycle in which it is imposed and would likely confuse consumers.

## ARGUMENT

### THE FEDERAL RESERVE BOARD'S REGULATION CLASSIFYING AN OVER-THE-LIMIT FEE AS NOT PART OF THE "FINANCE CHARGE" IS ENTITLED TO DEFERENCE

Respondent, a credit card holder, complains that the manner in which her credit card issuer disclosed on her periodic billing statements that it was imposing an over-the-limit fee because she had exceeded the credit limit violated the Truth in Lending Act (TILA), 15 U.S.C. § 1601 *et seq.* Pet. App. A3. There is no dispute that the credit card issuer clearly disclosed on respondent's billing statements the fact that the fee was imposed and the full amount of the fee. Respondent alleges, however, that the statute required her credit card issuer to classify the fee not as an "other charge," as the Federal Reserve Board's regulation requires, 12 C.F.R. §§ 226.4(c)(2), 226.7(h), but as part of the "finance charge" on her billing statements and to include it in the annual percentage rate (APR) calculation. Pet. App. A4.

The court of appeals agreed with respondent based on its own assessment of which classification would provide better information to respondent and other consumers. The court of appeals erroneously found TILA's definition of "finance charge" to be unambiguous and, at the same time, imposed an unworkable "knowingly" standard. That standard requires disclosure of an over-the-limit fee as part of the finance charge in "those instances in which the creditor knowingly permits the credit card holder to exceed his or her credit limit and then imposes a fee incident to the extension of that credit." Pet. App. A15 n.5. If such a case-by-case determination were required, however, the usefulness of the APR disclosure would be



diminished, and it would be more difficult for consumers to understand the imposition of over-the-limit fees in their current accounts. The court of appeals' second-guessing of the Board's regulation should be reversed to avoid such consequences that are contrary to the purposes of TILA.

#### A. Congress Granted The Federal Reserve Board Exceptionally Broad Regulatory Authority Under TILA And The Board's Determination Whether A Particular Type Of Fee Is Part Of The "Finance Charge" Is Entitled To Deference Unless Manifestly Contrary To The Statute Or Demonstrably Irrational

1. Congress declared that its purpose in enacting TILA was "to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices." 15 U.S.C. § 1601(a). TILA imposes on credit card issuers an extensive series of disclosure obligations relating to the fees and charges imposed as an incident to, as a part of, or in connection with, credit plans. TILA requires lenders that extend credit to consumers to explain the costs of their credit by disclosing the applicable "finance charge" and the APR based on the finance charge.[2] 15 U.S.C. § 1637. TILA also requires the lenders

[2] The APR listed in solicitations and advertisements reflects the interest rate that will be applied to any outstanding balance that the consumer may have in the future and typically is not tied to a specific loan amount. 15 U.S.C. § 1606; 12 C.F.R. § 226.14. In periodic billing

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to inform the consumer about "other charges" imposed as part of the credit plan. *Ibid.* Those requirements potentially apply to a wide variety of charges and fees that are imposed by credit card issuers. Creditors are constantly creating new credit products that have different features and they must be able to determine whether they are obliged to disclose the various terms of their credit products as part of the finance charge or as an other charge under TILA. These uniform disclosure obligations are designed to help consumers compare the cost of credit under different credit offerings. *See, e.g.*, S. Rep. No. 96-73, at 2 (1979) (suggesting that consumers would benefit from "heightened competition which would result from more knowledgeable credit shopping").

Therefore, in establishing those disclosure obligations, Congress "had to deal not only with the myriad forms in which credit transactions then occurred, but also with those which would be devised in the future." *Mourning v. Family Publ'ns Serv., Inc.*, 411 U.S. 356, 365 (1973). Congress recognized the difficulty of conveying complex credit information to customers in a comprehensible manner, including the need to avoid diluting the most important information that enables comparison shopping by disclosing too much detailed information. S. Rep. No. 96-73, at 3 (noting need to avoid providing consumers too much information that discourages them from studying the disclosure, and citing psychologist testimony about the "problem of 'informational overload'" which was an issue

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statements, however, the APR is calculated based on the actual balance in the account and the actual finance charge imposed during the billing cycle.



with the then-typical statement). Finally, Congress appreciated the importance of credit institutions and personal finance to the Nation's economy, expressly finding that "economic stabilization would be enhanced and the competition among the various financial institutions and other firms * * * would be strengthened by the informed use of credit." 15 U.S.C. § 1601(a); *see also Mourning*, 411 U.S. at 364 (explaining that TILA was enacted to address consumer ignorance of credit charges, and citing testimony that "such blind economic activity is inconsistent with the efficient function of a free economic system such as ours") (citation omitted).

In light of the difficulty of identifying, anticipating, and then appropriately classifying the variety of charges that may relate to a credit transaction, including new types of charges that arise with new credit products, Congress "determined to lay the structure of the Act broadly and to entrust its construction to an agency with the necessary experience and resources to monitor its operation." *Mourning*, 411 U.S. at 365. Congress wisely determined that an agency well-versed in banking transactions should be responsible for promulgating regulations to carry out the purposes of TILA and to make whatever classifications or exceptions as may be necessary to effectuate those purposes. 15 U.S.C. § 1604(a). Congress chose the Federal Reserve Board, which had been established as the nation's central bank in 1913, to be the agency to implement TILA and to promulgate regulations thereunder. Because it understands developments in credit markets, the Board has the institutional expertise to properly establish the requirements for disclosing the terms of credit products to consumers, taking into account consumer interests, the availability of credit, and other

pertinent considerations. H.R. Rep. No. 90-1040, at 18 (1967) ("[n]o one can deny" the "experience and expertise" of the Federal Reserve Board in matters of "finance charges in credit transactions").

One of the primary purposes of the Board's TILA regulation, known as "Regulation Z," has been to classify fees and charges as part of the "finance charge" or as "other charges" under TILA's disclosure requirements, and to distinguish them from fees and charges that are neither part of the finance charge nor other charges. Such classifications enable consumers to compare credit products and enable creditors to comply with the statute's disclosure requirements without being subject to private lawsuits for allegedly improper disclosure of fees.

2. This Court has long recognized the exceptionally broad authority that Congress vested in the Federal Reserve Board under TILA, including explicit authority to fill gaps in the statute through its Regulation Z. In *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555 (1980), the Court held that a high degree of deference is due even to interpretations of TILA by the Board's staff that were not promulgated in notice-and-comment regulation. *Id.* at 557, 564. The Court explained: "Because of their complexity and variety, * * * credit transactions defy exhaustive regulation by a single statute. Congress therefore delegated expansive authority to the Federal Reserve Board to elaborate and expand the legal framework governing commerce in credit." *Id.* at 559-560 (citing 15 U.S.C. § 1604 (1976); *Mourning*, 411 U.S. at 365-366). Indeed, the Court expressly noted that the Board "executed its responsibility by promulgating Regulation Z, 12 C.F.R.



Part 226 (1979), which at least partly fills the statutory gaps." *Milhollin*, 444 U.S. at 560.

The Court in *Milhollin* therefore concluded that, "[u]nless demonstrably irrational, Federal Reserve Board staff opinions construing the Act or Regulation should be dispositive * * *." 444 U.S. at 565. Logic compels the conclusion that even greater deference be due here, where the challenged regulation, 12 C.F.R. § 226.4(c)(2), is a provision of Regulation Z itself, and was thus issued pursuant to formal notice-and-comment rulemaking to fill the gaps left by Congress. *See Anderson Bros. Ford v. Valencia*, 452 U.S. 205, 219 (1981) (citing *Milhollin* as requiring deference to Board's regulation implementing TILA "absent some obvious repugnance to the statute").

Subsequent to *Milhollin*, this Court has reaffirmed the high degree of deference due an agency, like the Federal Reserve Board, that is vested by Congress with explicit regulatory authority greater than that typically granted by Congress. In such instances, the Court has held that greater deference should be accorded the agency's regulatory action than is required under the more common *Chevron* standard. When Congress has " 'explicitly left a gap for an agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation,' * * * and any ensuing regulation is binding in the courts unless procedurally defective, arbitrary or capricious in substance, or manifestly contrary to the statute." *United States v. Mead Corp.*, 533 U.S. 218, 227 (2001) (quoting in part *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-844 (1984)) (footnote omitted) (citations omitted).

3. TILA demonstrates that Congress gave the Board explicit authority to fill gaps regarding the classification of fees and charges as part of the "finance charge" or as "other charges."

a. From the outset, Congress not only provided the Federal Reserve Board the typical authority to "prescribe regulations to carry out the purposes" of TILA, but also specified that the Board's regulations "may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes [of TILA], to prevent circumvention or evasion thereof, or to facilitate compliance therewith." 15 U.S.C. § 1604 (1964 Supp. V), (currently codified at 15 U.S.C. § 1604(a)). Congress thereby granted the Board express authority to classify fees in a manner that the Board, in its judgment, deems proper to effectuate the statutory purpose or to facilitate compliance. To the extent that a classification is inconsistent with an express provision of TILA, Section 1604 also granted the Board explicit authority to make exceptions.

b. In 1995, Congress confirmed that TILA grants to the Federal Reserve Board the authority to promulgate regulations classifying certain fees and charges as part of the "finance charge" or excepting fees and charges therefrom. In enacting the Truth in Lending Act Amendments of 1995, Congress directed the Federal Reserve Board to prepare a report to "consider the extent to which it is feasible to include in finance charges" all the charges already described in the statutory definition of "finance charge," "especially those charges excluded from finance charges under [Section 1605]." Pub. L. No. 104-29, § 2(f),



109 Stat. 271-272 (1995) (*reprinted in* note following 15 U.S.C. § 1605). Congress also explicitly directed that the Board "shall prescribe any appropriate regulation in order to effect any change included in the report." *Ibid*. *See* H.R. Rep. No. 104-193, at 96 (1995) (explaining that the "definition of finance charge does not currently have a unified approach to fees," and that Congress was "direct[ing] the Federal Reserve Board to reexamine the costs that consumers incur in connection with an extension of credit and to determine how to calculate the finance charge to reflect more accurately these costs").

That directive reflects an understanding by Congress that the Federal Reserve Board enjoys primary interpretational authority concerning whether a particular charge is part of the "finance charge." It confirms that Congress intended the Board to define the contours of "finance charge."[3] It also makes clear that Congress views administrative action by the Board, not litigation, to be the means for resolving interpretational issues regarding which fees are included as part of the finance charge.[4]

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[3] The Board's regulation at issue here, 12 C.F.R. § 226.4(c)(2), was more than a dozen years old at the time of that 1995 congressional directive. Unlike the statutory exclusions in Section 1605 that Congress itself had created and then identified in the directive as warranting special reexamination by the Board, Congress did not identify the Board's regulatory classifications as something that the Board should reexamine. Certainly, if the Board's then-existing regulation regarding the scope of "finance charge" were not consistent with Congress's view of the statutory term or with its view of the Board's authority, one would have expected Congress to have directed the Board to reexamine that regulatory classification as well, but Congress did not do so.

[4] The Board's report in response to the 1995 directive analyzed the statutory framework, various public comments (*see* 60 Fed. Reg. 66,179 (Dec. 21, 1995) (soliciting comments on issue)), and the results of

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c. Other provisions of TILA confirm the Federal Reserve Board's broad authority with regard to disclosure requirements involving the finance charge. In Section 1637(a), Congress required creditors to disclose to consumers "other charges" that are imposed "as part of the plan" and left it to the Board to determine, through "regulations," the contours of such "other charges." 15 U.S.C. § 1637(a)(5). Also, in Section 1637(c)(5), Congress expressly granted the Board authority to go so far as to alter certain statutory disclosure requirements. Congress provided that the Board may, by regulation, "modify any disclosure of information required by" the statutory subsections governing disclosures in applications, solicitations, and renewals "if the Board determines that such action is necessary to carry out the purposes of, or prevent evasions of" any of those provisions. 15 U.S.C.

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meetings on the issue held by its Consumer Advisory Council. The Board acknowledged that there was "considerable appeal" in adopting a simpler approach of including every cost "associated with a consumer credit transaction" as part of the finance charge. Board of Governors of the Federal Reserve System, Report to the Congress, *Finance Charges for Consumer Credit Under the Truth in Lending Act* 10 (April 1996). But the Board ultimately concluded that "[a]ny such major change" would impose an extraordinarily high administrative cost and that the purported benefits did not clearly outweigh those costs. *Ibid.* The Board determined that such a change may not be the best approach to achieve "meaningful disclosures at all stages of the credit process and for all product types," *id.* at 11, and that it could be misleading due to the increase in the APR that would result and could erroneously suggest, for example, "that credit is substantially more expensive than leasing," *id.* at 10-11. The Board also emphasized that such a change in the scope of "finance charge" would require "an extensive consumer campaign of reeducation" or the resultant jump in the APR could "falsely suggest a changing rate environment in the economy." *Id.* at 11. Therefore, the Board did not make recommendations for change, but recommended further study of the matter. *Id.* at 12.



§ 1637(c)(5). *See also* 15 U.S.C. § 1632(a); 15 U.S.C. § 1632(c)(2)(B)(ii); 15 U.S.C. § 1606(c).

These provisions of TILA granting explicit regulatory power to the Board regarding the scope of "finance charges" and "other charges," as well as this Court's precedents interpreting the Board's broad authority, amply demonstrate that, under *Mead* and *Milhollin*, the Board's regulation classifying over-the-limit fees as not part of the finance charge is entitled to judicial deference unless that regulation is "manifestly contrary to the statute," *Mead*, 533 U.S. at 227-228, or "demonstrably irrational," *Milhollin*, 444 U.S. at 565.[5]

## B. The Board's Duly Promulgated Regulation Classifying Over-The-Limit Fees As Not Part Of The Finance Charge Is Not Manifestly Contrary To TILA Nor Demonstrably Irrational And Therefore Is Controlling

### 1. The Regulation Is Not Manifestly Contrary to TILA

The court of appeals erred in concluding that there is no ambiguity "within the statutory definition of a finance

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[5] There is no dispute here that Congress delegated to the Federal Reserve Board, under the first sentence of 15 U.S.C. § 1604(a), authority "generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority." *Mead*, 533 U.S. at 226-227. If that were the only grant of authority to the Board, this case would be governed by the more common *Chevron* test, under which the Court would determine whether the Federal Reserve Board's regulation classifying over-the-limit fees as not part of the finance charge is a reasonable interpretation of an ambiguous statutory provision. We demonstrate below that the Board's regulation meets that standard as well.

charge." Pet. App. A11. The description of "finance charge" set forth in Section 1605(a) does not unambiguously require that over-the-limit fees be classified as part of the finance charge and other provisions in TILA strongly indicate that Congress did not intend for it to so require. Therefore, the Board's regulatory classification of over-the-limit fees as not part of the finance charge is not manifestly contrary to the statute.

a. Congress provided that, for purposes of TILA, "the amount of the finance charge in connection with any consumer credit transaction shall be determined as the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit." 15 U.S.C. § 1605(a). That definition, by its terms, does not require that over-the-limit fees be part of the finance charge. Indeed, Congress provided a list of examples of charges that are included in the finance charge. 15 U.S.C. § 1605(a)(1)-(6). Congress also identified some categories of charges that are included in the finance charge only in certain circumstances, 15 U.S.C. § 1605(b), (c), and others that are not included, 15 U.S.C. § 1605(d), (e). None of those lists mention over-the-limit fees, reflecting the fact that TILA's definition of "finance charge" does not unambiguously identify whether such fees are part of the finance charge. *Cf. Mourning*, 411 U.S. at 373 (in light of broad grant of regulatory authority to the Board, declining to infer that references in TILA to certain transactions were intended to limit choice of the Board's treatment of other transactions).

b. Other provisions of TILA expressly provide that not all charges imposed by credit card issuers on consumers are part of the "finance charge." Some charges are



"other charges" and some charges are neither part of the finance charge nor other charges.

In Section 1637(a), where Congress has listed the items that must be disclosed to a consumer before establishing an open-ended credit plan, TILA requires disclosure of information about imposition of a "finance charge," the applicable periodic rate, and the nominal APR. 15 U.S.C. § 1637(a)(1)-(4). As noted above, TILA further provides for disclosure of "other charges." 15 U.S.C. § 1637(a)(5). The reference to "other charges" was included as part of the original statute in 1968, at the same time that the finance charge provision in Section 1605(a) was enacted. 15 U.S.C. § 1637(a)(6) (1964 Supp. V). In 1980, Congress reworded the "other charges" provision to require disclosure of "other charges which may be imposed as part of the plan, and their method of computation, in accordance with regulations of the Board." 15 U.S.C. § 1637(a)(5) (1976 Supp. V).

Thus, TILA distinguishes between charges that are "*imposed * * * as an incident to the extension of credit*" (*i.e.*, "finance charges under Section 1605(a)(5)), and charges that are "*imposed as part of the [credit] plan*" (*i.e.*, "other charges" under Section 1637(a)(5)). This distinction renders the finance charge provision ambiguous with respect to charges and fees that are not expressly identified as part of the finance charge. The statutory framework leaves it to the Board to classify what charges constitute "other charges" under Section 1637(a)(5). This is one of the gaps that Congress intended the Board to fill. *Cf.* 12 C.F.R. Part 226, Supp. I § 226.6(b)(2) (listing examples of charges that are not part of the finance charge nor "other charges").

c. Section 1637(c) expressly refers to over-the-limit fees in terms that strongly suggest that Congress did not

intend to require that these fees be part of the "finance charge," but rather viewed them as "other charges." Congress added Section 1637(c) to TILA in 1988 to require disclosure of certain information in solicitations and applications for both credit cards and charge cards. Congress defined "charge card" as "a card, plate or other single credit device that may be used from time to time to obtain credit *which is not subject to a finance charge.*" 15 U.S.C. § 1637(c)(4)(E) (1988) (emphasis added); *see* 15 U.S.C. § 1637(c)(4)(A)(iii) (1988) (charge cards require that payment for credit extended is due upon receipt of the billing statement). Nevertheless, Congress explicitly recognized that credit obtained under a charge card may be subject to an "[o]ver-the-limit fee," and Congress included that fee in a list of "[o]ther information" that must be disclosed in any written application or solicitation for a charge card. 15 U.S.C. § 1637(c)(4)(B), (C)(i)(II) (1988). The very fact that Congress understood that an over-the-limit fee could be imposed on a type of card that is not subject to a finance charge demonstrates that TILA does not require that over-the-limit fees be treated as part of the finance charge.

Moreover, Congress also explicitly described an over-the-limit fee in Section 1637(c) as "any fee *imposed in connection with an extension of credit*" that is in excess of the authorized credit limit. 15 U.S.C. § 1637(c)(4)(B)(iii) (1988) (emphasis added). Congress did not use the narrower phrase "*imposed * * * as an incident to the extension of credit*," as it had in the "finance charge" definition in Section 1605(a), thereby again demonstrating that Congress did not intend to require that an over-the-limit fee be part of the finance charge. *See also* 134 Cong. Rec. H9808 (daily ed. Oct. 6, 1988); 134 Cong. Rec. H10179 (daily ed.



Oct. 13, 1988) (describing over-the-limit fees as "ancillary fees" that must be disclosed in applications and solicitations in addition to the APR and information about applicable finance charges).

Finally, Congress treated over-the-limit fees similarly in the contemporaneously enacted provisions of Section 1637(c) relating to credit card disclosures in written applications and solicitations and relied on the same statutory description of "over-the-limit" fees. Congress again expressly listed over-the-limit fees under the heading "[o]ther information." It further provided that such fees must be disclosed "[i]n addition to" the minimum finance charges and APR required to be disclosed under the immediately preceding subsections relating to credit cards. 15 U.S.C. § 1637(c)(1)(B)(iii) (1988); *see also* 15 U.S.C. § 1637(c)(3)(B)(i)(II) (1988); 15 U.S.C. § 1637(c)(3)(D)(ii) (1988). Congress thereby evidenced no intention to treat over-the-limit fees for credit cards differently than it did for charge cards.

In view of these many features of TILA's text and structure, it cannot be said that Section 1605(a) precludes over-the-limit fees from being classified as something other than part of the finance charge because such fees (1) are not included in Section 1605(a) as an example of part of the finance charge; (2) are described by Congress in Section 1637(c) in express statutory language that is different from the statutory language used to describe the finance charge in Section 1605(a); and (3) are identified by Congress in Section 1637(c) as "other information." The references to "over-the-limit fees" in Section 1637(c) create a serious ambiguity as to whether the term "finance charge" in Section 1605(a) includes over-the-limit fees. *Cf. Sullivan v. Stroop*, 496 U.S. 478, 484 (1990) (relying on the

"normal rule of statutory construction that 'identical words used in different parts of the same act are intended to have the same meaning.'") (quoting *Sorenson v. Secretary of the Treasury*, 475 U.S. 851, 860 (1986) and earlier cases). For these reasons, the Board's regulation is not manifestly contrary to the statute.

**2. The regulation is not demonstrably irrational**

a. The Board duly promulgated 12 C.F.R. § 226.4(c)(2) in 1981, as part of its Regulation Z, to classify over-the-limit fees as not part of the finance charge. At the same time and in the same manner, the Board promulgated the provision that requires disclosure in periodic billing statements of all "[o]ther charges," *i.e.*, the "amounts, itemized and identified by type, of any charges other than finance charges debited to the account during the billing cycle." 12 C.F.R. § 226.7(h). Both provisions were promulgated pursuant to formal notice-and-comment rulemaking, 5 U.S.C. § 553, as part of the Board's complete revision of Regulation Z that was necessitated by Congress's enactment of the Truth in Lending Simplification and Reform Act (1980 Simplification Act), Pub. L. No. 96-221, Title VI, 94 Stat. 132, 168 (1980). The Board's revision to Regulation Z was "the culmination of several years of effort to reduce the difficulties of compliance, to clear up troublesome ambiguities that had been the source of much litigation, and to make credit disclosures more meaningful to consumers." Board of Governors of the Federal Reserve System, 68th Annual Report 149 (1981). In particular, one "major aspect[ ] of the Board's effort to reduce compliance burdens include[d] the adoption of



clear-cut rules" that the Board hoped would "require less interpretation and thereby reduce litigation." *Ibid.*

b. The over-the-limit fee regulation appropriately carries out the purposes of TILA and is a classic example of the exercise of explicit regulatory authority to fill a statutory gap and make "classifications" to "effectuate the purposes" of TILA or to "facilitate compliance therewith." 15 U.S.C. § 1604(a). *See* Pet. App. A22 (Edgar, Chief D.J., concurring in part and dissenting in part) (the Board's regulation "filled in a blank left by Congress in the TILA").

The district court below correctly recognized that the regulation classifies as not part of the "finance charge" several "categories of charges, all of which arise when the terms under which the credit was extended have been breached by the borrower," including unanticipated late fees, fees for exceeding a credit limit, and charges arising out of delinquency or default. Pet. App. A28. "All of these post-credit extension occurrences are done in violation of the agreed upon terms upon which the credit was extended. Such charges are never imposed upon a borrower who simply follows the terms of the agreement." *Ibid.* Because these charges are based on a breach of the agreement by the borrower, the Board could rationally include these charges as one of the classes of charges that are not part of the finance charge.

The court of appeals' contrary approach introduces an issue of "knowingly" into the determination whether an over-the-limit fee is part of the finance charge. The court of appeals emphasized that its requirement that over-the-limit fees be disclosed as part of the finance charge "is of course limited to those instances in which the creditor knowingly permits the credit card holder to exceed his or

her credit limit and then imposes a fee incident to the extension of that credit." Pet. App. A15 n.5. But mandating such a case-by-case determination would mean that an over-the-limit fee sometimes would be classified as part of the "finance charge" and included in the APR on a consumer's periodic billing statement, but at other times would be classified as an "other charge" and not included in the APR, even in a subsequent periodic billing statement for the same account.

That approach would confuse consumers and not assist in their understanding of the finance charge or APR. It would be inconsistent with Congress's goal of having disclosures made in a uniform manner, so as to enable consumers "to compare more readily the various credit terms available" to them. 15 U.S.C. § 1601(a). And it would be contrary to the Board's intent that Regulation Z "improve the delivery of credit-shopping information to consumers, * * * reduce costs related to compliance litigation, and redirect enforcement efforts to the most important matters." Board of Governors of the Federal Reserve System, 67th Annual Report 171 (1980). Therefore, the Board was well within its authority to consider such consequences in deciding to classify over-the-limit fees as "other charges."

c. Discerning whether a creditor "knowingly" permitted a consumer to exceed the credit limit in any particular instance, as the court of appeals would require, is an exceedingly difficult undertaking because of the way that these transactions are authorized. For example, authorizations through Visa and MasterCard were established to provide the merchant's bank some assurance that the credit card charge will be accepted by the credit card issuer. The issuer generally may not refuse to accept a



cardholder charge that it has authorized, and the merchant's bank bears the risk if there was no authorization by the Visa or MasterCard system. But that authorization process does not authorize the cardholder to exceed his credit limit. Thus, the court of appeals clearly erred in viewing the authorization system as a means by which a consumer and his credit card issuer "renegotiate" the terms of a credit account. *See* Pet. App. A13.

The authorization system cannot, and is not designed to, determine whether a particular charge, at a given time, will cause an account to exceed its credit limit. That is because some merchants such as car rental agencies request authorization for amounts that exceed the amount of the actual transaction. Others may request authorization for transactions that are never completed or for nominal amounts that are much less than the actual transaction that is carried out. Some merchants do not seek authorization at all for some transactions. *See* Br. for *Amici Curiae* American Bankers Association, *et al.* Supp. Pet. for Cert. 8, 15-16 (Feb. 4, 2003) (providing a more detailed description of authorization process). Also, the computer systems for authorizations do not have continuous real-time information regarding all charges, credits, and payments which may be in transit, or may not yet have cleared through the processing system. *See id.* at 8-9.

d. The court of appeals' uncertain "knowingly" standard resurrects an approach that the Federal Reserve Board rejected as inappropriate in 1981, when it promulgated its over-the-limit fee regulation. As noted above, that regulatory action was necessitated by Congress's enactment of the 1980 Simplification Act. The need for simplification and reform had come about, in

part, because of the uncertainty surrounding what fees are part of the "finance charge." In the early years following the 1968 enactment of TILA, there was an "explosion of lawsuits," including "countless suits over hairsplitting nuances of disclosure." Ralph J. Rohner & Fred. H. Miller, *Truth In Lending* 787 (2000). Requests for agency guidance yielded "more than 1,500 official and unofficial interpretations" by the staff of the Federal Reserve Board "of what Regulation Z required." *Ibid.* That "vast subbody" of jurisprudence, as well as judicial decisions that sometimes conflicted with those interpretations or with one another, meant that "[c]ertainty of compliance was impossible." *Ibid.*

The Board's initial proposed rule in 1980 would have added over-the-limit charges to the pre-existing regulation that classified late fee charges and charges for delinquency, default or similar occurrences as part of the finance charge, only if they were imposed for such an occurrence that was "actual" and "unanticipated." 45 Fed. Reg. 29,702, 29,735 (May 5, 1980). When the Board issued its second proposed rule for comment, however, that provision was changed to classify over-the-limit fees as not part of the finance charge without consideration of whether such a fee was unanticipated in a particular case. 45 Fed. Reg. 80,648, 80,697 (Dec. 5, 1980).

The modification regarding how to classify over-the-limit fees was in keeping with one of the substantive changes reflected in the second proposed regulation and emphasized by the Board, *i.e.*, that "[d]isclosures would be based only on the legally enforceable obligation between the parties, not on any unenforceable understanding which is at variance with the contract" between the consumer and the creditor. 45 Fed. Reg. at 80,650. That



shift was consistent with what the Board understood to be "the thrust of the Truth in Lending Act as amended," which is "to provide customers with an accurate picture of the obligation to which they will be legally bound." 45 Fed. Reg. at 80,677. Thus, even if the court of appeals were correct in its theory that respondent alleged that petitioner knowingly imposed the over-the-limit fee on respondent based on some understanding between them about an additional extension of credit, *see* Pet. App. A12-A13, the Board was well within its broad authority discussed above when it classified all over-the-limit fees as not part of the finance charge, but required disclosure as an other charge. *Cf. Lopez v. Davis*, 531 U.S. 230, 244 (2001) (agency "has the authority to rely on rulemaking to resolve certain issues of general applicability unless Congress clearly expresses an intent to withhold that authority," and agency "is not required continually to revisit 'issues that may be established fairly and efficiently in a single rulemaking proceeding'") (citations omitted); *see also Mourning*, 411 U.S. at 374 (recognizing necessity of administrative line-drawing under TILA because "the transactions or conduct which Congress seeks to administer occur in myriad and changing forms").

e. Finally, the Board's determination that an over-the-limit fee should not be disclosed as part of the finance charge rationally furthers the interests of consumers. As explained above, the Board requires that such a fee be separately disclosed as an "other charge" and itemized on periodic billing statements. 12 C.F.R. § 226.7(h) (requiring disclosure of "[t]he amounts, itemized and identified by type, of any charges other than finance charges debited to the account during the billing cycle"). That separate disclosure of an over-the-limit fee highlights for the

consumer the amount of and type of fee charged and identifies it as a charge that is incurred only if the customer exceeds the terms of the credit limit, not as a regular monthly charge whenever any credit is extended under the account.

To include an over-the-limit fee as part of the finance charge on a periodic billing statement "would substantially increase (and distort) the APR for the billing cycle in which they were imposed." Board of Governors of the Federal Reserve System, Report to the Congress, *Finance Charges for Consumer Credit Under the Truth in Lending Act*, at 3 (April 1996) (making same point with regard to why certain other fees are not included in the finance charge). That distortion would occur because imposition of an over-the-limit fee does not reflect a step-up in the interest rate charged on the account. An over-the-limit fee typically is a fixed amount, $29.00 in the case of respondent's account, Pet. App. A36, and is unrelated to the amount of any extension of credit. Credit card issuers generally do not impose over-the-limit fees on every transaction that causes an account to exceed the credit limit at a given time. They typically impose over-the-limit fees only when the account balance exceeds the credit limit at the end of the billing cycle, or for a period of several weeks or days. If a transaction causes the account to exceed the credit limit temporarily and the credit card issuer receives a payment from the consumer before the end of the billing cycle, the issuer often does not impose any over-the-limit fee.

Adding such a fee to the APR would likely confuse consumers. Today, most consumers receiving solicitations offering a credit card account already have one or more credit cards. These consumers need to be able to compare



the terms of their current accounts with the terms of accounts offered to them. As explained above, TILA requires that over-the-limit fees be disclosed separately from the APR and the minimum finance charge on written applications and solicitations for credit cards. *See* 15 U.S.C. § 1637(c)(1), (3). Thus, a consumer comparing the APR on his billing statement to the one on an account that is offered to him in an advertisement or a direct solicitation would be misled about the comparative costs of credit if an over-the-limit fee were included in the APR on the billing statement.

By contrast, the Board's requirement that the over-the-limit fee be separately disclosed in billing statements, as it was indisputably done on respondent's billing statements, is consistent with the statutory provisions requiring separate disclosure of over-the-limit fees on credit and charge card applications. It is likewise consistent with the Board's regulation, 12 C.F.R. § 226.5a(b)(10), requiring the disclosure of over-the-limit fees on or with an application to open a credit or charge card account. The Board's over-the-limit regulation means that the nature of an over-the-limit fee is highlighted for the consumer on his periodic billing statement and can be easily compared to similar fees under other credit offers or plans.

The above demonstrates that the Board's regulation classifying an over-the-limit fee as not part of the finance charge was lawfully promulgated, is not manifestly contrary to TILA or demonstrably irrational and, therefore, is controlling.

## CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed.

Respectfully submitted,

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# In the Supreme Court of the United States

HOUSEHOLD CREDIT SERVICES, INC. AND MBNA AMERICA BANK, N.A., PETITIONERS

*v.*

SHARON R. PFENNIG

*ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT*

## BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONERS

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## QUESTION PRESENTED

Whether the Federal Reserve Board reasonably classified a fee imposed by a credit card lender because a consumer has exceeded the credit limit as one of the "other charges which may be imposed" under the account (15 U.S.C. 1637(a)(5)) rather than a "finance charge" (15 U.S.C. 1605(a)), within the meaning of the Truth in Lending Act, 15 U.S.C. 1601 *et seq.*

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## BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONERS

## INTEREST OF THE UNITED STATES

The Truth in Lending Act (TILA or Act) imposes disclosure requirements on creditors that offer consumer credit plans, such as credit cards. The Board of Governors of the Federal Reserve System (Board) is authorized to issue regulations to carry out the Act. 15 U.S.C. 1604(a). The Board has promulgated a regulation interpreting TILA to provide that fees for exceeding a credit limit should be disclosed as "other charges" (15 U.S.C. 1637(a)(5)) rather than part of the "finance charge" (15 U.S.C. 1605(a)). The Board and the United States have an interest in defending that interpretation. The United States filed an amicus brief at the petition stage in response to this Court's order inviting the Solicitor General to express the views of the United States.

## STATEMENT

1. a. The Truth in Lending Act, 15 U.S.C. 1601 *et seq.*, establishes a comprehensive scheme that requires lenders to disclose credit terms to consumers. The disclosures for open-end credit plans, such as the credit card account in this case, vary depending on the stage in the lending process. But the Act and its implementing regulation, Regulation Z (12 C.F.R. Pt. 226), together provide at every stage for disclosure of the fee at issue here—an over-the-credit-limit (OCL) fee, which TILA describes as a "fee imposed in connection with an extension of credit in excess of the amount of credit authorized to be extended with respect to [the] account" (15 U.S.C. 1637(c)(1)(B)(iii)).

TILA also requires disclosures at various times of the "finance charge" (15 U.S.C. 1605(a)) and the "annual percentage rate" (APR) (15 U.S.C. 1606(a)). The "finance charge" is "the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit." 15 U.S.C. 1605(a). Although TILA gives examples of charges that must be included in the finance charge and charges that may or must be excluded, OCL fees are not mentioned in either category. 15 U.S.C. 1605. The APR for an open-end plan is "the quotient (expressed as a percentage) of the total finance charge for the period to which it relates divided by the amount upon which the finance charge for that period is based, multiplied by the number of such periods in a year." 15 U.S.C. 1606(a)(2). Thus, when a finance charge for a given period includes a fee in addition to the account's nominal interest rate, the APR for the period generally increases above the nominal rate to reflect that fee.

TILA requires creditors offering open-end accounts to make disclosures to consumers in solicitations or applications, again before opening the account, and thereafter for each billing cycle under the plan. Direct-mail applications and solicitations must inform consumers of the APRs that may apply under the plan and must specify certain other fees that may be assessed under the plan, including OCL fees. 15 U.S.C. 1637(c)(1) and (3). Additional disclosures before opening the account must identify the conditions under which a finance charge may be imposed, the method used to determine the balance on which a finance charge will be imposed and to determine the amount of the finance charge, and the nominal APR that will be applied to balances. 15 U.S.C. 1637(a)(1)-(4). Creditors must also identify "other charges which may be imposed as part of the plan." 15 U.S.C. 1637(a)(5). For each billing cycle, the creditor must provide a periodic statement that includes, among other things, the outstanding balance, an itemization of the extensions of credit during the billing cycle, the amount of any finance charge added to the account during the billing cycle, and the total finance charge expressed as an APR. 15 U.S.C. 1637(b).

b. TILA gives the Board broad authority to issue regulations to carry out its purposes. The regulations "may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of [the Act], to prevent circumvention or evasion thereof, or to facilitate compliance therewith." 15 U.S.C. 1604(a). Creditors that act in good faith reliance on a rule, regulation, or interpretation by the Board or its staff are protected from liability under the civil liability provisions of TILA, even if the rule or interpretation is later rescinded by the Board or held invalid by a court. 15 U.S.C. 1640(f). In order to achieve nationwide uniformity in disclosure requirements, state laws that are inconsistent with TILA or the Board's regulations imple-

menting TILA are expressly preempted. 15 U.S.C. 1610; 12 C.F.R. 226.28(a).

The Board's Regulation Z, adopted pursuant to Section 1604(a), identifies a number of fees that are excluded from the finance charge. 12 C.F.R. 226.4(c). Those fees include "[c]harges for actual unanticipated late payment, for exceeding a credit limit, or for delinquency, default, or a similar occurrence." 12 C.F.R. 226.4(c)(2). The regulation thus expressly excludes OCL fees from the finance charge.

The exclusion of OCL fees dates from a 1981 revision to Regulation Z, which was promulgated following notice and comment. See 45 Fed. Reg. 29,702, 29,735 (1980) (proposed rule); *id.* at 80,648, 80,697 (revised proposal); 46 Fed. Reg. 20,848, 20,855, 20,894 (1981) (final rule). Even before the revision, however, the Board and its staff had issued opinions interpreting the pre-1981 regulatory language to exclude the OCL fees at issue in the opinions from the finance charge. See Official Interpretive Letter FC-0142 (Fed. Reserve Bd. Jan. 9, 1978); Unofficial Staff Interpretation PI-1281 (Fed. Reserve Bd. Feb. 14, 1978).

Consistent with the statutory disclosure requirements, Regulation Z requires creditors to make disclosures with direct-mail applications and solicitations, before the initial use of a credit card plan, and with each billing cycle. 12 C.F.R. 226.5a, 226.6, 226.7. Each of those disclosures must include information about the finance charge and the APRs that may be or were imposed in connection with the credit plan. 12 C.F.R. 226.5a(b), 226.6(a), 226.7(f) and (g). In addition, each of the disclosures must identify OCL fees that may be or have been imposed. Direct-mail applications and solicitations must identify the amount of the OCL fee that the plan might impose. 12 C.F.R. 226.5a(b)(10). OCL fees must also be disclosed before the account is used, and periodic statements must disclose OCL fees if they were imposed during the billing cycle. 12 C.F.R. 226.6(b), 226.7(h)



(requiring disclosure of "other charges" in initial disclosures and periodic statements); 12 C.F.R. Pt. 226 Supp. I, Official Staff Interpretations, Cmts. 6(b)-1(i), 7(h)-4 (listing OCL fees among the "other charges" that must be disclosed).

2. Respondent Sharon Pfennig is a consumer who holds a credit card account originally issued by an affiliate of petitioner Household Credit Services, Inc., and now held by petitioner MBNA America Bank, N.A. On behalf of a purported nationwide class of petitioners' customers, respondent sued petitioners in the United States District Court for the Southern District of Ohio. Pet. App. A31-A41. Respondent alleged that petitioners allowed her to incur charges that caused her balance to exceed her credit limit and then violated TILA when they failed to disclose the resulting OCL fee as a finance charge or to include it in the APR on her periodic statement. *Id.* at A32-A33, A39-A40. Respondent did not allege that petitioners failed to disclose the OCL fee as an "other charge," as required by Regulation Z.

The district court granted petitioners' motion to dismiss the complaint. Pet. App. A24-A29. The court observed that Regulation Z specifically provides that an OCL fee is not a finance charge. *Id.* at A27. The court noted that the regulation excludes from the finance charge several fees, including late fees, delinquency charges, and OCL fees, "all of which arise when the terms under which the credit was extended have been breached by the borrower." *Id.* at A28. The court concluded that the "Board rationally determined that those charges, for acts amounting to breaches of the agreed upon credit extension, are not finance charges." *Ibid.* Accordingly, the court deferred to the Board's regulation, as required under *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555 (1980), and held that petitioner's complaint fails to state a claim upon which relief can be granted. Pet. App. A28.

3. A divided panel of the United States Court of Appeals for the Sixth Circuit reversed. Pet. App. A1-A23. The court

acknowledged its obligation under this Court's decisions to give "deference * * * to the [Board]'s interpretation of [TILA] as long as such interpretations are not irrational." *Id.* at A6. Nonetheless, the court of appeals declined to defer to Regulation Z's provision that OCL fees are not part of the finance charge. *Id.* at A8-A15.

The court of appeals first stated that, "as a remedial statute, [TILA] must be given a liberal interpretation in favor of consumers." Pet. App. A8. The court then went on to conclude that the OCL fee imposed here "falls squarely within the statutory definition of a finance charge." *Id.* at A9. The court noted that TILA defines the finance charge as "the sum of '*all charges*'" paid by the borrower and assessed by the creditor "as an incident to the extension of credit." *Ibid.* The court read respondent's complaint to allege that she was charged OCL fees after she requested and was granted additional credit, because the complaint alleged that petitioners allowed her to incur the charge that caused her account to exceed the credit limit. *Ibid.* The court stated that, "under a plain reading of § 1605(a) and the general rules of statutory interpretation, the [OCL] fee was imposed incident to the extension of credit to [respondent]." *Ibid.*

The court also noted the centrality of disclosure of the finance charge to TILA's remedial purpose, and expressed the view that "'[s]eeing the cold, hard figures [i.e., the finance charge] helps consumers to determine whether to use credit or not,' as high credit costs encourage restraint." Pet. App. A12 (citation omitted). Accordingly, the court concluded that, "considering the language in § 1605(a) defining the finance charge and the language and purpose of TILA as a whole, Regulation Z's exclusion of over-limit fees, such as those imposed in this case, from the 'finance charge' conflicts with the express language of TILA," and "the regulation cannot stand." *Ibid.* The court noted, however, that its holding applies only when "the creditor knowingly permits



the credit card holder to exceed his or her credit limit." *Id.* at A15 n.5.

Finally, the court of appeals considered petitioners' liability to respondent in light of the good faith immunity defense of 15 U.S.C. 1640(f). Pet. App. A15-A18. The court stated that, because the fee in question "was imposed for 'exceeding a credit limit,'" and Regulation Z "unequivocally" permits petitioners to disclose the fee as they did, petitioners were entitled to the good faith defense. *Id.* at A17. The court accordingly affirmed the dismissal of respondent's claim for monetary damages. *Id.* at A18.

Chief District Judge Edgar (sitting by designation) dissented from the court's holding that Regulation Z is invalid. Pet. App. A19-A23. In particular, Judge Edgar disagreed with the court's conclusion that TILA's language unambiguously requires inclusion of OCL fees as part of the finance charge. Observing that OCL fees are not mentioned in TILA's definition of "finance charge," Judge Edgar reasoned that, although the panel majority's interpretation of the statutory language "might well be a reasonable one," the Board's reading is also reasonable. *Id.* at A22. In his view, the Board reasonably analogized OCL fees to other charges, such as those for late payment or delinquency, that "are clearly not a part of the finance charge." *Ibid.* Judge Edgar noted that, in *Milhollin*, this Court held that the Board's regulations construing TILA are "dispositive" unless "demonstrably irrational." *Ibid.* (quoting *Milhollin*, 444 U.S. at 565). Judge Edgar would therefore have deferred to the Board's regulation, which he viewed as a reasonable interpretation of TILA. See *ibid.*

Petitioners sought rehearing and rehearing en banc, and the Board filed an amicus brief in support. Pet. App. A43-A53. The Board's brief took issue with the court's conclusion that an OCL fee is necessarily within the statutory definition of "finance charge." *Id.* at A45-A47. In addition, the Board

challenged the court's assumption that, because petitioners allegedly approved the transaction that caused respondent to exceed her credit limit, petitioners had knowingly permitted respondent to exceed her credit limit and thereby agreed to a renegotiation of the credit limit. *Id.* at A47-A51. The Board explained that creditors almost never have the real-time information necessary to determine whether a particular credit transaction for which approval is being sought will actually cause a consumer to exceed a credit limit. *Id.* at A48-A50. For that reason, when a creditor authorizes a transaction that will ultimately cause the consumer to exceed the credit limit, the creditor is generally not knowingly extending credit in excess of the limit. Creditors therefore do not impose OCL fees until the conclusion of the billing cycle, and the decision to impose the fee is based on a backward look at the account history. *Id.* at A50-A51. The Board also explained that the court's decision would create serious compliance difficulties for creditors and confusion among consumers. *Id.* at A51-A52.

The court denied panel rehearing but amended its opinion to add a footnote that rejected the Board's arguments. See Pet. App. A10 n.2. The court dismissed the Board's explanation of industry practice and the reasons for the regulation as facts that "were never raised below and are not in the record." *Ibid.* The court suggested that concerns about the invalidation of the regulation could be addressed at trial, at which time petitioners could challenge respondent's allegations that they knowingly allowed her to exceed her credit limit by permitting her to incur the charge that had that result. *Id.* at A10-A11 n.2. The full court later denied the petition for rehearing en banc. *Id.* at A30.

## SUMMARY OF ARGUMENT

I. This Court has held that the regulations and interpretations of the Board and its staff under TILA should be "dis-



positive" unless "demonstrably irrational." *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 565 (1980); see *Anderson Bros. Ford* v. *Valencia*, 452 U.S. 205, 219 (1981) (Board's regulations should be accepted "absent some obvious repugnance to the statute"). The deference rule articulated in *Milhollin* and *Valencia* applies in any case in which a statutory gap or ambiguity in TILA is clarified by a Board regulation or interpretation.

This case involves precisely that situation. TILA does not directly address whether or not fees for exceeding the credit limit on a credit card account (OCL fees) are included in the "finance charge." The "finance charge" is defined to include all charges "incident to the extension of credit," but that phrase is ambiguous. 15 U.S.C. 1605(a). Although the definition of finance charge gives examples of fees that are included and specifies fees that are excluded, the definition does not address OCL fees. Moreover, other provisions of TILA make clear that not every charge associated with a credit agreement is included in the finance charge. And, when TILA expressly addresses OCL fees elsewhere in the Act and requires their disclosure, it does not classify them as finance charges.

In its Regulation Z implementing TILA, the Board has interpreted "finance charge" to exclude OCL fees and other fees that are imposed when a consumer violates the terms of a credit agreement. 12 C.F.R. 226.4(c)(2). Those fees must be disclosed to consumers, but they are disclosed as "other charges," and thus not reflected in the annual percentage rate set forth on a consumer's periodic statement. See 12 C.F.R. Pt. 226 Supp. I, Official Staff Interpretations, Cmts. 6(b)-1(i), 7(h)-4. The Board's classification of OCL fees as "other charges" rather than part of the "finance charge" is a reasonable interpretation of TILA.

OCL fees, like other penalty fees, are rationally viewed as imposed "incident to" the consumer's breach of the agree-

ment rather than "incident to the extension of credit." For the creditor, those fees serve important functions apart from compensating for increased credit risk resulting from a higher balance. For the consumer, those fees are not integral to the cost of credit under the agreement, because the consumer will not incur them by borrowing in accordance with the agreement's terms. Treating all penalty-type fees alike facilitates compliance with TILA by providing creditors with a clear and simple rule and effectuates TILA's purposes by ensuring that consumers are provided with understandable information with which to compare credit costs.

II. The court of appeals erred in invalidating the Board's regulation. The court's reasoning reflects a misunderstanding of the operation of the credit card industry and a mistaken focus on the creditor's knowledge of the consumer's account status. The court of appeals erroneously assumed that the point-of-sale authorization of a transaction that ultimately causes a consumer to exceed her credit limit represents a knowing decision by the creditor to allow the consumer to exceed the limit. On the contrary, the authorization process is designed for a distinct purpose and reflects imperfect information that does not accurately indicate to the creditor whether a particular transaction will push the consumer over the credit limit.

The court also mistakenly assumed that a creditor renegotiates the credit limit when the creditor approves a charge through the point-of-sale authorization process with the awareness that the charge will cause the consumer to exceed the credit limit. If the creditor does not also agree to raise the credit limit for the future, approval of such a transaction does not in itself amount to a renegotiation of the credit limit, and any OCL fee is reasonably viewed as imposed for the breach of the agreement. Nor does the court of appeals' focus on the creditor's knowledge find any other support in



TILA's text. Enforcing a distinction in the disclosure of OCL fees on that basis, moreover, would create a substantial compliance burden for creditors and lead to consumer confusion, thus undermining the purposes of TILA. In any event, even if some small percentage of OCL fees could be classified as "finance charges," the Board acted reasonably in adopting a categorical approach that treats all OCL fees alike.

Finally, the court of appeals was not justified in rejecting the Board's regulation based on TILA's "remedial" purpose and the court's belief that an alternative rule would better protect consumers. Pet. App. A11-A12. The court was incorrect that its rule better protects consumers, and, more fundamentally, it usurped the Board's authority by substituting its own policy judgment for the judgment made by the Board.

## ARGUMENT

### THE BOARD'S REGULATION Z, WHICH EXCLUDES OCL FEES FROM THE FINANCE CHARGE, REASONABLY RESOLVES AMBIGUITY IN TILA AND SHOULD BE UPHELD

Congress enacted TILA to promote "the informed use of credit" by ensuring "meaningful disclosure of credit terms" to consumers. 15 U.S.C. 1601. Recognizing that the complexity and variety of credit transactions prevents TILA from itself addressing every disclosure issue, Congress delegated expansive authority to the Board to interpret and elaborate upon the Act. 15 U.S.C. 1604. Exercising that authority, the Board has provided in Regulation Z, TILA's implementing regulation, that fees for exceeding the credit limit on a credit card account (OCL fees) are disclosed, not as part of the "finance charge" (15 U.S.C. 1605(a)), but instead as one of the "other charges which may be imposed" under the account (15 U.S.C. 1637(a)(5)). See 12 C.F.R. 226.4(c)(2); 12 C.F.R. Pt. 226 Supp. I, Official Staff Interpretations,

Cmts. 6(b)-1(i), 7(h)-4. The Board's regulation reasonably resolves ambiguity in TILA concerning the treatment of OCL fees and should be upheld by this Court.

## I. REGULATION Z REFLECTS A REASONABLE APPROACH TO THE DISCLOSURE OF OCL FEES

### A. The Board's Regulations Under TILA Are Entitled To Extraordinary Deference

When a statute is "silent or ambiguous with respect to the specific issue" covered by an authorized and validly promulgated regulation, courts generally must defer to the regulation if it is "based on a permissible construction" of the statute. *Chevron U.S.A. Inc.* v. *Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843 (1984); see *United States* v. *Mead Corp.*, 533 U.S. 218, 229-230 (2001). That principle has heightened force in the context of regulations issued by the Board under TILA.

As this Court has explained, TILA gives the Board unusually "broad administrative lawmaking power." *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 566 (1980). See 15 U.S.C. 1604(a) (empowering Board to issue regulations containing such "classifications," "differentiations," "adjustments," and "exceptions" as are "necessary or proper to effectuate the purposes" of TILA). Furthermore, Congress "has specifically designated the Federal Reserve Board and staff as the primary source for interpretation and application of" TILA. *Milhollin*, 444 U.S. at 566. Because creditors need "sure guidance" on how to comply with the "highly technical" Act, Congress has acted to promote reliance on Federal Reserve interpretations by providing creditors with a defense from liability for good faith reliance on rules, regulations, or interpretations by the Board. *Id.* at 566-567; see 15 U.S.C. 1640(f).

That provision is necessary because TILA contains substantial sanctions for violations. Statutory damages, costs,



and attorneys' fees are available for misstatement of the finance charge, and for the overstatement or understatement of the APR by more than 1/8 of one percent in an open-end account. 15 U.S.C. 1606(c), 1640(a); 12 C.F.R. 226.7(f), 226.14(a). If lenders could not rely on Board regulations and interpretations as authoritative statements of TILA's requirements, lenders operating nationwide or regional credit programs would be paralyzed by judicial rulemaking, which might impose different disclosure requirements from jurisdiction to jurisdiction.

The good faith reliance defense "relieve[s] the creditor of the burden of choosing 'between the Board's construction of the Act and the creditor's own assessment of how a court may interpret the Act.'" *Milhollin*, 444 U.S. at 567 (quoting S. Rep. No. 278, 93d Cong., 1st Sess. 13 (1973)). And, as this Court explained in *Milhollin*, that provision also "signals an unmistakable congressional decision to treat administrative rulemaking and interpretation under TILA as authoritative." *Id.* at 567-568.

In addition, because TILA's goal is to enable consumers to compare credit costs so that they can make informed credit decisions, uniform disclosures are critical to the Act's success. Maintaining uniformity in the disclosure regime would be nearly impossible if the disclosure requirements were interpreted through litigation, which is not "the optimal process by means of which to formulate a coherent and predictable body of technical rules." *Milhollin*, 444 U.S. at 568 n.12. Recognizing that fact, the legislative history of TILA "evinces a decided preference for resolving interpretive issues by uniform administrative decision, rather than piecemeal through litigation." *Id.* at 568.

Further, as the Court also explained in *Milhollin*, deference to the Federal Reserve "is compelled by necessity" because the "concept of 'meaningful disclosure' that animates TILA cannot be applied in the abstract." 444 U.S. at 568 (ci-

tation omitted). Meaningful disclosure "does not mean *more* disclosure" but rather entails a policy balance between "competing considerations of complete disclosure" and avoiding "informational overload." *Ibid.* The Board is better suited than the courts to strike the appropriate balance, because doing so requires "investigation into consumer psychology" and "broad experience with credit practices." *Id.* at 568-569.

For those reasons, this Court has adopted an extremely deferential standard for review of Board rules interpreting and implementing TILA. The Court has held that, "[u]nless demonstrably irrational," constructions of TILA by the Board or its staff "should be dispositive." *Milhollin*, 444 U.S. at 565. Thus, "absent some obvious repugnance to the statute, the Board's regulation implementing [TILA] should be accepted by the courts." *Anderson Bros. Ford* v. *Valencia*, 452 U.S. 205, 219 (1981).

That approach makes particular sense in the context of this case. The issue here is not whether OCL fees should be disclosed, but whether they should be disclosed as part of the "finance charge" or as "other charges." On such matters, the precise format for disclosure is less important than providing creditors with clear guidance and ensuring that consumers receive uniform information.

### B. TILA Itself Does Not Address Whether OCL Fees Are Included In The Finance Charge

This case involves a straightforward application of the deference rule articulated in *Milhollin* and *Valencia*. TILA does not directly address whether OCL fees should be disclosed as part of the finance charge or instead as other charges that may be incurred under a credit card plan. TILA defines the "finance charge" to include "all charges" imposed on the consumer by the creditor "as an incident to the extension of credit." 15 U.S.C. 1605(a). But TILA makes clear that not every charge associated with a credit



agreement is "incident to the extension of credit." And TILA does not resolve whether OCL fees fall within that descriptive phrase.

The phrase "incident to the extension of credit" is ambiguous. As this Court has recognized, although the preposition "incident to" implies some connection between its object and the antecedent, the term alone does not identify the "nature or extent of the required connection." *Holly Farms Corp.* v. *NLRB*, 517 U.S. 392, 403 n.9 (1996). The "line between practices that are and those that are not performed 'as an incident to or in conjunction with' [other specified activities] is not susceptible to precise definition," and "is not so 'plain' as to bear only one permissible construction." *Id.* at 408 (citing 29 C.F.R. 780.144). Courts should therefore defer to an expert agency's reasonable view of where that line should be drawn. *Id.* at 408-409.

In this case, moreover, surrounding provisions of TILA make clear that Congress did not intend the "incident to" language to incorporate every charge related to an extension of credit. The section defining "finance charge" indicates that certain charges that could reasonably be viewed as "incident to" an extension of credit are not part of the finance charge. See 15 U.S.C. 1605(a) (certain closing costs in real estate transactions); 15 U.S.C. 1605(b) (certain premiums for credit and other types of insurance); 15 U.S.C. 1605(d) (disclosed fees relating to perfecting security interests); 15 U.S.C. 1605(e) (various identified fees incident to the extension of credit secured by real property). Moreover, rather than providing an exhaustive compendium of the items that are included in the finance charge, the definition of finance charge lists "[e]xamples" of charges that are included. 15 U.S.C. 1605(a). Finally, the section prescribing disclosures for open-end credit plans, such as credit card accounts, requires separate disclosure of "other charges which may be imposed as part of the plan" in addition to

disclosure of the method of determining the finance charge. 15 U.S.C. 1637(a)(3) and (5).

Those provisions indicate that the scope of the "finance charge" is not self-evident from the phrase "incident to the extension of credit." Neither the "examples" nor the express exclusions would be necessary if charges "incident to the extension of credit" unambiguously included all those connected to the credit agreement. The requirement that "other charges" be disclosed also would be superfluous if the phrase "incident to the extension of credit" encompassed every charge associated with the extension of credit.

Nor does TILA's text definitively resolve whether OCL fees are included in the finance charge. None of the various examples of charges that are included in the finance charge and none of the specific exclusions address OCL fees. See 15 U.S.C. 1605(a)-(e). Indeed, to the extent that TILA's text expressly addresses OCL fees, it supports the Board's regulatory conclusion that OCL fees are not finance charges. Where TILA addresses OCL fees and requires their disclosure, it does not classify them as finance charges. See 15 U.S.C. 1637(c)(1)(B)(iii) (applications and direct mail solicitations for credit card accounts). Nor does TILA, when it references OCL fees, describe them as imposed "incident to" an extension of credit. See *ibid.* (using the broader phrase "in connection with" rather than the phrase "incident to"). Thus, although Congress was clearly aware of OCL fees, it neither included them in the definition of finance charge nor classified them as finance charges.

### C. Regulation Z Reasonably Provides That OCL Fees Are "Other Charges" And Not Part Of The Finance Charge

Because TILA does not itself expressly address the proper classification of OCL fees, the Board, in its implementing regulation, had to decide whether to classify them



as part of the "finance charge" (15 U.S.C. 1605(a)) or instead as one of the "other charges which may be imposed as part of the [credit] plan" (15 U.S.C. 1637(a)(5)). TILA gives the Board broad authority to make "such classifications * * * as in the judgment of the Board are necessary or proper to effectuate [its] purposes." 15 U.S.C. 1604(a). Exercising that authority, the Board reasonably classified OCL fees as other charges rather than finance charges.

That determination is embodied in Regulation Z's exclusion from the finance charge of "[c]harges for actual unanticipated late payment, for exceeding a credit limit, or for delinquency, default, or a similar occurrence." 12 C.F.R. 226.4(c)(2). Those fees must instead be disclosed separately as "other charges." 12 C.F.R. Pt. 226 Supp. I, Official Staff Interpretations, Cmts. 6(b)-1(i), 7(h)- 4.

The Board's determination reflects that those fees are imposed only if the consumer violates the terms of the credit agreement. Because such penalty-type fees are not imposed for the extension of credit in accordance with the agreement but instead for activity in contravention of the agreement, the Board does not consider those fees to be imposed "as an incident to the extension of credit" within the meaning of 15 U.S.C. 1605(a). Accordingly, they are not included in the finance charge.

Excluding from the finance charge fees imposed for the consumer's violation of the terms of the credit agreement is entirely rational. For the creditor, those fees serve important functions apart from compensating for increased credit risk resulting from the higher balance. They deter consumers from violating the agreement and compensate the creditor for the additional risk inherent in dealing with a consumer who does not abide by the agreement's terms. For the consumer, such fees are not integral to the cost of credit under the agreement, because the consumer will not incur them by borrowing in accordance with the agreement. The

Board reasonably concluded that consumers will find the finance charge more meaningful when comparing credit costs if it is calculated based on the assumption that consumers comply with the terms of their credit agreements.

The Board also reasonably concluded that treating penalty-type fees uniformly, rather than distinguishing among them in ways that may not be significant to consumers or creditors, will best facilitate consumer understanding and industry compliance. See 45 Fed. Reg. 80,648 (1980) (noting the value of "precise, easily-applied rules"). A rule that all fees imposed for violation of the terms of the credit agreement are excluded from the finance charge is clear, straightforward, and thus easy for consumers to understand and creditors to follow. In contrast, a rule that drew distinctions among those similar fees might lead to errors in creditors' disclosures or render the disclosures unnecessarily complicated and confusing to consumers.

Based on those considerations, and on its experience under the previous version of Regulation Z in attempting to classify OCL fees on a case-by-case basis, the Board, in 1981, adopted a categorical approach and amended the regulation to list OCL fees among the fees for violating a credit agreement that are expressly excluded from the finance charge. See 46 Fed. Reg. 20,855 (1981) (noting that the revision "adds one item to the list" of penalty fees excluded from the finance charge by "specifically exclud[ing] charges for exceeding a credit limit from the finance charge"). Although the Board and its staff had issued opinions interpreting the pre-1981 regulation to exclude the OCL fees at issue in the opinions from the finance charge, the regulation did not expressly address OCL fees. The 1981 amendment evinces the Board's now long-held judgment that OCL and other penalty



fees are best considered as a group and uniformly excluded from the finance charge.[1]

## II. THE COURT OF APPEALS ERRED IN FAILING TO DEFER TO REGULATION Z

Because TILA does not expressly address the proper treatment of OCL fees, and the Board's regulation classifying them as "other charges" rather than part of the "finance charge" is eminently rational, the court of appeals should have deferred to the regulation. Instead, the court held that "the regulation cannot stand" (Pet. App. A12) and adopted its own interpretation of TILA under which OCL fees are sometimes finance charges and sometimes not, depending on whether "the creditor knowingly permits the credit card holder to exceed his or her credit limit" (*id.* at A15 n.5). None of the reasons advanced by the court of appeals for its holding withstands scrutiny.

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[1] The 1981 regulatory amendments were made in response to the Truth in Lending Simplification and Reform Act, Pub. L. No. 96-221, Tit. VI, 94 Stat. 168. In making the amendments, the Board concluded that its prior approach, under which disclosure obligations were based on the actual agreement between the parties even if that differed from the parties' legally enforceable obligations, was not consistent with regulatory simplification. The Board therefore determined that disclosure obligations should "be based only on the legally enforceable obligation between the parties, not on any unenforceable understanding which is at variance with the contract." 45 Fed. Reg. at 80,650; see *id.* at 80,733 (noting that the change was designed to provide clearer standards); *id.* at 80,677 (stating that the prior approach "has proven difficult in application and frequently complicates both the compliance and enforcement burdens"); see also 12 C.F.R. 226.5(c) (codifying the change for open-end credit plans). The categorical exclusion of penalty fees in the current regulation is consistent with that general policy change.

### A. The Court Of Appeals' Analysis Ignores The Actual Operation Of The Credit Card Industry

The primary rationale that the court of appeals proffered for rejecting the Board's regulation was that the OCL fees in this case "fall[] squarely within the statutory definition of a finance charge" (Pet. App. A11) because they must be viewed as imposed "incident to the extension of credit" (*id.* at A9). The court concluded that the fees were "incident to the extension of credit" because respondent alleged that they were imposed after petitioners permitted her to incur charges that caused her to exceed the credit limit. *Id.* at A9, A12-A13, A15 n.5. The court equated that allegation with a claim that petitioners knowingly allowed respondent to exceed the limit. *Id.* at A13, A15 n.5. The court then reasoned that respondents thereby "renegotiate[d]" the original agreement to allow respondent more credit, and that a fee imposed as a result of that new agreement is necessarily "incident to this extension of credit." *Id.* at A13. That reasoning is flawed.

The court mistakenly assumed that the point-of-sale authorization of a transaction that pushes a consumer over her credit limit involves a knowing decision by the creditor to allow the consumer to exceed the limit. On the contrary, as the Board explained in its amicus brief below, the point-of-sale authorization process serves different purposes and does not permit a creditor accurately to determine whether authorizing a specific purchase will push a consumer over the credit limit. The authorization process permits a merchant to check whether a card is stolen, the account has been terminated, or transactions on the account have been blocked. The review is handled electronically and virtually instantaneously. Although a part of the review involves a check on the amount of outstanding charges and the credit limit on the account, the authorization process is not



designed to, and does not generally, indicate accurately to either the merchant or the creditor whether a transaction will cause a consumer to exceed the credit limit. Pet. App. A48-A50.

There are a number of practical reasons why the authorization system is not suited accurately to identify over-limit transactions. First, credits to an account are not posted until the end of the day. Thus, at the time authorization is requested, payments or refunds may have been received but not yet posted, so that the charge for which authorization is requested may appear to put the consumer over the limit when in fact it will not do so. Similarly, a transaction that appears to be within a customer's credit limit may simply reflect the fact that other, pre-existing charges have not yet been posted to the authorization system's database. Pet. App. A49.[2]

Second, merchants often seek authorization for amounts that do not reflect actual charges. Some merchants seek authorization for a nominal amount to determine whether a consumer has a "live" card. As a result, the consumer's obligations may be temporarily understated until the merchant posts the actual charge. Other merchants, such as hotels and

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[2] In fact, the situation is even more complex because Regulation Z requires a payment to be posted to an account "as of" the day that it is received, even if it takes a few days for the creditor to process the payment. 12 C.F.R. 226.10(a). Although the "as of" date determines whether the credit limit has been exceeded, the payment does not appear in the authorization database until it is actually processed. For example, a creditor that received a payment on Tuesday would have to post it to the account "as of" that day, even if the payment was not processed and recorded until Thursday. An OCL fee could not be assessed for a charge incurred on Wednesday if the payment brought the balance below the credit limit, even though, at the time that the transaction was authorized on Wednesday, the authorization database would not have reflected the payment, which had not yet been processed.

car rental facilities, block large amounts of credit when a customer checks in or rents a car to ensure that payment will be authorized when the customer checks out or returns the car. That practice means that the consumer's obligations are temporarily overstated. Pet. App. A49-A50.

Those and similar practices result in substantial inaccuracies in the database check performed when a merchant seeks authorization for a credit transaction. A creditor who declined to authorize a transaction because it was potentially over the credit limit based on information available in the authorization database might cause needless hardship and embarrassment to cardholders, and deny credit transactions to which cardholders are entitled by contract. The same limitations that would cause these mistaken credit denials prevent issuers from determining in real time that a transaction is over the limit for purposes of imposing an OCL fee.

For that reason, creditors do not impose OCL fees at the time that they authorize a transaction that may cause the account balance to exceed the credit limit. Instead, they determine whether to impose an OCL fee at the end of the billing cycle, when they can ascertain whether, in light of all charges and credits, the consumer has in fact exceeded the credit limit, and when they can consider other factors, such as the consumer's payment history, the amount by which the limit is exceeded, and how long the account was in over-limit status. Pet. App. A50. For the same reasons, the Board has never placed any significance on what the merchant authorization process might indicate about the possibility that an OCL fee will later be imposed. Instead, the Board rationally characterizes *all* OCL fees as charges for violating the credit agreement rather than finance charges.[3]

[3] The court's statement (Pet. App. A10 n.2) that the Board conceded that there may be instances in which an OCL fee is a finance charge is not correct. The court relied on a footnote in the Board's amicus brief that observes in passing that an OCL fee may not be bona fide in certain limited circumstances. See *id.* at A50-A51 n.8. The Board's brief refers to a situation where a charge is mislabeled as an OCL fee when it is not in fact a penalty imposed for breaching the agreement but is imposed for some other reason. The court seized on that statement as a concession that there were in fact questions for trial. *Id.* at A10. As the Board carefully pointed out in its brief, however, there is no allegation in this case that the fees charged respondent were anything other than bona fide OCL fees. Indeed, the Sixth Circuit itself accepted that the fees imposed here were bona fide OCL fees within the meaning of Regulation Z in holding that petitioners are entitled to immunity from damages. *Id.* at A17 ("it is undisputed that the fee at issue in this case was imposed for 'exceeding a credit limit' ").



### B. The Court Of Appeals' Focus On The Creditor's Knowledge Is Mistaken

The court of appeals apparently declined to consider the ordinary operation of the credit card industry because it construed respondent's complaint to allege that petitioners had actual knowledge that the charges that triggered the OCL fees in this case would cause respondent to exceed her credit limit. Pet. App. A10-A11 n.2, A15 n.5.[4] The court suggested that petitioners could avoid liability if they establish at trial that they lacked such knowledge. *Id.* at A11 n.2. But a "knowing" authorization of a transaction that triggers an OCL fee does not in itself amount to a renegotiation of the credit limit. Nor does TILA otherwise make the creditor's

[4] The court also disregarded the Board's explanation of the actual workings of the credit card industry because the information had not been presented to the district court and was not in the record. Pet. App. A10 n.2. But the Board, which is not a party to this case, was not aware of the case when it was in the district court, and the rationality of the Board's regulation cannot be meaningfully assessed without consideration of the information. Moreover, the Board presented the information to counter the court's incorrect assumptions about the operation of the credit card industry, which themselves are without support in the record.

knowledge of the consumer's account status determinative of whether a fee is a finance charge.

1. Even in the unlikely event that petitioners did have actual knowledge that the charges they authorized would cause respondent to exceed her credit limit, it would not follow, as the court of appeals reasoned, that petitioners thereby agreed to a new credit limit going forward and that the subsequent OCL fees were therefore "incident to the extension of credit." Respondent did not allege that petitioners agreed to establish a new credit limit for the future term of a credit agreement. To the contrary, respondent viewed the case as involving OCL fees, which, by definition, involve charges imposed for "exceeding a credit limit." 12 C.F.R. 226.4(c)(2); see Pet. App. A17 (noting that "it is undisputed that the fee at issue in this case was imposed for 'exceeding a credit limit'"). If petitioners had increased respondent's credit limit when authorizing the transactions that triggered the fees, then the fees would not have been "for exceeding a credit limit" because the authorized transactions would not have caused respondent to exceed the new credit limit. Thus, there is no basis to conclude that the authorizations that triggered the OCL fees in this case involved a renegotiation of respondent's credit limit, and consequently there is no basis to conclude that the OCL fees were imposed "incident to the extension of credit."

It is also not necessarily correct, as a general matter, that a creditor's authorization of a transaction knowing that it will cause the customer to exceed the agreed-upon credit limit amounts to a renegotiation of the credit limit for the future. It is just as reasonable to assume that, when a creditor authorizes such a transaction, the creditor is simply allowing a one-time breach of the agreement, subject to existing contractual remedies for that breach. In that case, there would be no renegotiation of the credit agreement, and any fee imposed would still have resulted from the borrower's



violation of the agreement. Accordingly, it would still be reasonable to view the fee as imposed "incident to" the breach of the credit agreement rather than "incident to the extension of credit." Nothing in TILA compels a contrary approach.[5]

2. Nor does anything else in TILA support the court of appeals' conclusion that the Act requires the Board to distinguish among OCL fees based on whether or not the creditor knew that the consumer would breach the credit agreement. The court's rule finds no support in TILA's text. Nothing in the definition of finance charge suggests that whether a fee is a finance charge should turn on the creditor's subjective knowledge of the consumer's current account status. See 15 U.S.C. 1605(a). Nor do any other provisions of TILA require such a rule.[6]

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[5] In some circumstances, it might be reasonable to interpret the phrase "incident to" to permit an act to be "incident to" more than one thing. See *Holly Farms*, 517 U.S. at 403 n.10. Because of TILA's premium on clear and understandable rules, however, it was surely reasonable for the Board to interpret the Act's ambiguous language to preclude such a result under the circumstances here.

[6] The fact that Regulation Z excludes charges for late payment only if the late payment is "actual" and "unanticipated" does not support the court's rule. See 12 C.F.R. 226.4(c)(2). Those limiting adjectives are necessary because the extension of credit always involves a charge for "late payment" in the sense that the creditor permits deferred payment in exchange for a fee. The regulation describes the late payment fees that are excluded from the finance charge as fees for "actual" and "unanticipated" late payment to ensure that the excluded fees are for late payment in contravention of the credit agreement rather than for deferred payment contemplated by the agreement. OCL fees, and other fees for delinquency and default, are by their very nature fees for violating the terms of the agreement; they can never be fees for deferred payment contemplated by the agreement. Therefore, the regulation does not qualify their exclusion from the finance charge with the adjectives "actual" and "unanticipated."

On the contrary, the court's rule would undermine TILA's emphasis on clear and administrable disclosure rules and frustrate TILA's purposes by confusing consumers and unnecessarily burdening creditors. Consumer confusion would result because OCL fees would be disclosed differently on a consumer's periodic statements depending on whether or not the fees were assessed for charges that the creditor knew would cause the consumer to exceed the credit limit. Thus, the periodic statements could vary from month to month for reasons that would be unclear to the consumer. If an OCL fee was imposed based on a charge that the creditor did not know would cause the consumer to exceed the limit, the OCL fee would be listed among the other transactions charged to the account and would have no impact on the APR. If, however, an OCL fee was imposed based on a charge that the creditor knew would cause the consumer to exceed the limit, the OCL fee would be disclosed with a conspicuous label such as "FINANCE CHARGE"[7] and would cause an unexplained increase in the APR for that billing cycle. A consumer would likely be puzzled, and would certainly not be enlightened, by those different disclosures of fees that, from his point of view, result from the same action. Pet. App. A51-A52.

Requiring creditors to distinguish in disclosing OCL fees on the basis of their "knowledge" would also substantially burden card issuers. Issuers would be required to draw lines between OCL fees imposed following a "knowing" authorization and those imposed in the more common "unknowing" circumstances. They would also have to develop complex systems to capture information relevant to whether or not each authorization was "knowing." The cost of misclassification would be significant. Creditors face statutory damages for violations of TILA or Regulation Z equal to twice the finance charge for the transaction (up to the lesser of $500,000 or 1% of the creditor's net worth in the case of class actions), and also must pay the costs of the action and attorneys' fees. 15 U.S.C. 1640(a). Incorrectly placing a "finance charge" in the "other charge" category would subject the lender to liability for misstating the amount of the finance charge. See 12 C.F.R. 226.7(f); 15 U.S.C. 1640(a). If the APR were overstated or understated by more than 1/8 of one percent, that, too, would be a violation. See 12 C.F.R. 226.14(a); 15 U.S.C. 1606(c).

[7] When used with a corresponding amount, the term "finance charge" must be more conspicuous than other required disclosures. 15 U.S.C. 1632(a); 12 C.F.R. 226.5(a)(2).



The statutory and regulatory scheme places a premium on clear rules that give the regulated community the necessary notice to comply. The Sixth Circuit's case-specific, knowledge-based standard is inconsistent with that scheme. With the costs of misclassification so high, and little or no benefit to consumers from a classification scheme as finely calibrated as the Sixth Circuit's, the Board rationally adopted a simple rule that classifies all OCL fees as "other charges," and, at the same time, requires disclosure of those fees in every case.

### C. The Board Has Authority To Adopt A Categorical Approach Excluding All OCL Fees From The Finance Charge Even If Some OCL Fees Are Imposed Incident To The Extension Of Credit

Even if the court of appeals were correct that the particular OCL fees in this case were imposed incident to the extension of credit, that would not justify invalidation of the Board's regulation adopting a categorical approach and excluding OCL fees as a class from the finance charge. As already noted, TILA authorizes the Board to make "such classifications, differentiations, or other provisions, and [to] provide for such adjustments and exceptions for any class of

transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of [TILA], to prevent circumvention or evasion thereof, or to facilitate compliance therewith." 15 U.S.C. 1604(a). Pursuant to that authority, the Board's regulation treats all OCL fees in the same manner and excludes all of them from the finance charge. That classification is rational and not repugnant to TILA, even if one assumes that some OCL fees fall within the definition of a finance charge.

As explained above, in the ordinary operation of the credit card industry, creditors do not know when they authorize a particular transaction whether or not the transaction will cause the consumer to exceed her credit limit. Thus, in most cases, creditors cannot accurately determine whether or not the authorization will ultimately result in the imposition of an OCL fee. It is therefore reasonable to conclude that any OCL fee that is subsequently imposed is not "incident to the extension of credit" but rather incident to the consumer's violation of the credit agreement. Consequently, it is reasonable to classify most OCL fees as "other charges" rather than "finance charges."

Because most OCL fees are reasonably classified as "other charges," the Board could rationally adopt a categorical approach that treats all OCL fees in that manner. As explained above, treating all OCL fees alike facilitates compliance and consumer understanding by providing a clear and uniform rule, consistent with the rule applied to other fees for violations of the credit agreement. See p. 18, *supra*. In addition, the Board's knowledge of the credit card industry suggests that, even if there were a theoretical possibility that certain OCL fees might fall within the definition of "finance charge," it is unlikely that situation would occur with any frequency in practice, and the costs of identifying such occurrences would not be justified. Under those circumstances, the broad deference granted the Board by Congress



clearly encompasses the authority to adopt a bright-line approach excluding OCL fees as a class from the "finance charge." See 15 U.S.C. 1604(a); *Valencia*, 452 U.S. at 222-223 (deferring to Board's interpretation of Regulation Z as excluding certain interest from disclosure as a "security interest" despite apparently contrary statutory and regulatory language); *Mourning* v. *Family Publ'ns Serv. Inc.*, 411 U.S. 356, 374 (1973) (Board's broad regulatory authority under TILA permits it to make classifications that encompass some "conduct the legislation was not intended to deter or control" in order to ensure that "clear violators" do not "escape regulation entirely").

### D. The Court Of Appeals Was Not Justified In Rejecting The Board's Rule Based On TILA's "Remedial" Purpose And The Court's Belief That An Alternative Rule Would Better Protect Consumers

The court of appeals' other reason for invalidating the Board's rule also lacks merit. The court classified TILA as "a remedial statute" and purported to give it "a liberal interpretation in favor of consumers in order to protect them in credit transactions." Pet. App. A8-A9; see *id.* at A11-A12. By making its own policy judgment about what would best protect consumers, the court usurped the role that Congress has given to the Board of "striking the appropriate balance" between "complete disclosure" and "informational overload." *Milhollin*, 444 U.S. at 568. In the Board's view, explained above, the interpretation adopted by the court of appeals is not more protective of consumers and indeed will cause consumer confusion. In any event, it is for the Board, not the courts, to determine how such policy considerations should shape disclosure requirements in areas not governed by a clear statutory command. See *id.* at 568-569.

More than 20 years ago, this Court noted Congress's "preference for resolving interpretive issues [under TILA]

by uniform administrative decision, rather than piecemeal through litigation." *Milhollin*, 444 U.S. at 568. The Court explained that administrative rulemaking more readily produces the "coherent and predictable body of technical rules" demanded by this complex Act. *Id.* at 568 n.12. The Court admonished lower courts to "honor that congressional choice" and "refrain from substituting their own interstitial lawmaking for that of the [Board], so long as the latter's lawmaking is not irrational." *Id.* at 568. The Sixth Circuit's decision disregards that admonition and threatens a return to an era when courts routinely issue interpretations of TILA that conflict with those of the Board. Both Congress and this Court have made clear that such judicial rulemaking is antithetical to this statutory scheme.

## CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 2003

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HOUSEHOLD CREDIT SERVICES, INC. and
MBNA AMERICAN BANK, N.A.,

*Petitioners,*

v.

SHARON R. PFENNIG,

*Respondent.*

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**On Writ of Certiorari to the
United States Court of Appeals for the Sixth Circuit**

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## BRIEF FOR WILLIAM P. SCHLENK, PETITIONER IN U.S. CASE NO. 03-112, AS *AMICUS CURIAE* SUPPORTING PETITIONERS

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## QUESTION PRESENTED

Whether the Sixth Circuit improperly substituted its interpretation of the Truth in Lending Act for that of the Federal Reserve Board — the agency authorized by Congress to interpret the statute — in invalidating an important provision of Regulation Z that affects tens of millions of consumer credit card agreements?

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## INTEREST OF *AMICUS CURIAE*

The *amicus curiae*, William P. Schlenk, is the petitioner in *Schlenk v. Ford Motor Credit Corp.*, U.S. Case No. 03-112 (petition for *certiorari* filed July 11, 2003), in which his petition for a writ of *certiorari* is currently pending before the Court. He respectfully submits that he has a direct interest in the issues presented here, which overlap significantly with the issues presented in his own case.[1]

In both of these cases, the Sixth Circuit Court of Appeals considered and decided issues raised under the Truth in Lending Act, 15 U.S.C. § 1601 *et seq*. ("TILA"), and the implementing regulations adopted by the Federal Reserve Board, which is the expert agency charged by Congress with the authority to administer the TILA. In both cases, as the *amicus curiae* and petitioners here contend, the Sixth Circuit erred by failing to give proper deference to the Board's controlling interpretation of these statutes and of its own regulations that implement the statutory terms. This case concerns the Board's Regulation Z as applied to consumer credit card transactions, whereas the *Schlenk* case concerns the Board's Regulation M as applied to motor vehicle leasing transactions. Yet there is no meaningful difference in the controlling statutory and regulatory principles that govern these and other similar cases brought to enforce the terms of the TILA.

This brief *amicus curiae* is submitted for two reasons. First, we intend to illustrate more fully the immense breadth of the categories of consumer transactions covered by the TILA, which in turn fortifies the Court's mandate of judicial deference to the Board exercising its expert regulatory authority. Second, we intend to underscore the evenhandedness of the rule of deference that the Court applies in these situations. As shown

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[1] The parties have consented to the filing of this brief in letters that are on file with the Clerk. Pursuant to S. Ct. R. 37.6, the undersigned counsel for the *amici curiae* state that they alone have authored this brief, and no other persons or entities made any monetary contribution to its preparation or submission.

by the specific contrast between the facts of this case and the facts of the *Schlenk* case, a regime of judicial deference to agency action does not systematically advantage any particular set of judicial parties.

For these reasons, the *amicus curiae* has a direct interest in the issues presented here and submits this brief in an attempt to be of assistance to the Court in this case.

## SUMMARY OF ARGUMENT

The core issue in this case, on which the court below erred, concerns the proper level of deference that courts are supposed to give to actions taken by the Federal Reserve Board to implement the provisions of the Truth in Lending Act. The Court has already spoken to this precise issue in several prior decisions, which have uniformly held that the Board is entitled to substantial deference in interpreting and enforcing these statutes and its own implementing regulations. *See, e.g.*, *Mourning v. Family Publication Serv., Inc.*, 411 U.S. 356, 363-75 (1973); *Ford Motor Co. v. Milhollin*, 444 U.S. 555, 559-69 (1980); *Anderson Bros. Ford v. Valencia*, 452 U.S. 205, 211-23 (1981). In a sense, these holdings simply appear to be standard applications of the Court's settled approach to the broader issue of the proper relationship between the judicial power to interpret and apply the law and the administrative function to exercise delegated authority as a means to fill in the details of congressional enactments. *See, e.g.*, *United States v. Mead Corp.*, 533 U.S. 218 (2001); *Auer v. Robbins*, 519 U.S. 452 (1997); *Chevron U.S.A., Inc. v. Natural Resources Defense Ccl., Inc.*, 467 U.S. 837 (1984).

In this particular context, however, the Court has gone somewhat further, holding that because Congress has conferred such unusually "broad administrative lawmaking power" upon the Board and its staff, "a court that tries to chart a true course to the Act's purpose embarks on a voyage without a compass when it disregards the agency's views." *Milhollin*, 444 U.S. at 566. Indeed, the Court has squarely held that the Board and its staff must be treated as one and the same for purposes of affording judicial deference, since "Congress has conferred



special status upon official staff interpretations. *See* 15 U.S.C. § 1640(f); 12 C.F.R. § 226.1(d) (1979)." *Id.* at 566 n.9. By these means, Congress expressed its decisive "preference for resolving interpretive issues [under the TILA] by uniform administrative decision, rather than piecemeal through litigation," in order to produce the "coherent and predictable body of administrative rules" demanded by this complex statute. *Id.* at 568 & n.12.

The rationale for this approach remains sound. If anything, the immense breadth of the categories of consumer transactions covered by the TILA, which has greatly expanded even since the Court decided *Mourning* and *Milhollin*, fortifies in turn the Court's steadfast determination to require judicial deference to the Board's exercise of its expert regulatory authority. As the Court has cogently stated: "Because of their complexity and variety, however, credit transactions defy exhaustive regulation by a single statute. Congress therefore delegated expansive authority to the Federal Reserve Board to elaborate and expand the legal framework governing commerce in credit." *Milhollin*, 444 U.S. at 559-60. Those categories of consumer transactions range, for example, from the ubiquitous credit card transactions whose regulation is under review in this case to the motor vehicle leases at issue in *Schlenk* – which by themselves now constitute a multi-billion-dollar industry.

In addition, the propriety of this approach is underscored by the evenhandedness of the rule of deference that the Court has embraced to govern the situations that arise in this case, the *Schlenk* case, and many other such cases. The Federal Reserve Board, of course, is entirely neutral as a regulatory body. It adopts administrative rules that it judges to be most faithful to the text and purposes of the TILA, and most sensible to balance the rights and interests of consumers against those of the vendors and providers with whom they transact business. The Board supplements and elaborates its rules with official staff commentary that clarify and explain in greater detail how and why those regulations apply to particular transactions and distinct scenarios. As shown by the contrast between the circumstances of this case and the facts of the *Schlenk* case, a

consistent rule of judicial deference to agency expertise and delegated congressional authority does not uniformly favor either plaintiffs or defendants, consumers or vendors. The settled approach of great deference to the Board's interpretation of its own governing statutes and regulations is right not because it presses forward any particular policy agenda, but by virtue of the fact that it is true to the appropriate relationships among the three branches of the Federal government.

## ARGUMENT

### I. THE SIXTH CIRCUIT ERRED BY REFUSING TO DEFER TO THE FEDERAL RESERVE BOARD'S BINDING CONSTRUCTION OF ITS OWN STATUTES AND REGULATIONS.

The question presented here is whether the Sixth Circuit improperly substituted its interpretation of the Truth in Lending Act for that of the Federal Reserve Board, thereby effectively invalidating a regulation that affects tens of millions of consumer credit card arrangements. In light of the background to the TILA and the Court's consistent construction of the regulatory regime administered pursuant to these statutes, the court below clearly erred.

#### A. Statutory and Regulatory Background.

Congress passed the Truth in Lending Act in 1968, 82 Stat. 148, 15 U.S.C. § 1601 *et seq*., which "culminated several years of congressional study and debate as to the propriety and usefulness of imposing mandatory disclosure requirements on those who extend credit to consumers in the American market." *Mourning v. Family Publication Serv., Inc.*, 411 U.S. 356, 363 (1973). "Because of the divergent, and at times fraudulent, practices by which consumers were informed of the terms of the credit extended to them, many consumers were prevented from shopping for the best terms available and, at times, were prompted to assume liabilities they could not meet." *Id.*

In the text of the Act itself, Congress stated the key findings that justified the new legislation:



> The informed use of credit results from an awareness of the cost thereof by consumers. It is the purpose of this subchapter to assure a meaningful disclosure of credit terms, so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit and to protect the consumer against inaccurate and unfair credit billing and credit card practices.

15 U.S.C. § 1601. To this end, the House Committee on Banking and Currency reported that "by requiring all creditors to disclose credit information in a uniform manner, . . . the American consumer will be given the information he needs to compare the cost of credit and to make the best informed decision on the use of credit." H.R. Rep. No. 1040, 90th Cong., 1st Sess. 13 (1967).

Because the provisions of the law and practices in this field are complicated, Congress empowered the Federal Reserve Board "to define such classifications as were reasonably necessary to insure that the objectives of the Act were fulfilled." *Mourning*, 411 U.S. at 366; *see also Milhollin*, 444 U.S. at 559-60 ("Because of their complexity and variety, however, credit transactions defy exhaustive regulation by a single statute. Congress therefore delegated expansive authority to the Federal Reserve Board to elaborate and expand the legal framework governing commerce in credit."). Pursuant to that extensive regulatory authority, the Board adopted Regulation Z, which specifies in detail various permissible and impermissible aspects of consumer credit charges, including what is and is not to be included in finance charges. *See* 12 C.F.R. Part 226; *see also* 15 U.S.C. § 1604(a). In 1976, Congress supplemented the provisions of the TILA by extending its coverage to leasing transactions, which were becoming increasingly prevalent among consumers. *See* Consumer Leasing Act, 90 Stat. 259, 15 U.S.C. § 1667 *et seq*. The Board implemented the consumer leasing provisions of the TILA by adopting its Regulation M. *See* 12 C.F.R. Part 213.

### B. The Court Has Mandated that the Board's Definitive Interpretation of Its Governing Statute and Rules Merits Broad Deference.

The Sixth Circuit erred in this case because it failed to give deference to the agency's own definitive interpretation of its governing statute. The TILA is no more than "silent or ambiguous with respect to the specific issue" of whether the over-limit fee at issue in this case is either a "finance charge" within the meaning of 15 U.S.C. § 1605(a) or one of the "other charges which may be imposed" on the account as countenanced by 15 U.S.C. § 1637(a)(5). *Chevron*, 467 U.S. at 843. In such circumstances, this Court has firmly held that "considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer . . . and the principle of deference to administrative interpretations has been consistently followed by this Court." *Id.* at 844 (footnote and quotation omitted); *see also United States v. Mead Corp.*, 533 U.S. 218, 227-31 (2001) (reaffirming *Chevron* rule and explicating agency materials, such as administrative regulations and other less formal indices of agency decisionmaking, that are entitled to receive judicial deference). The Court has based this jurisprudential approach on its recognition that an agency's authority to administer the governing statutes in the substantive area entrusted to it by Congress "necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress." *Morton v. Ruiz*, 415 U.S. 199, 231 (1974). And where the agency's construction of its governing statutes relies in part on an interpretation of its own regulations, substantial judicial deference is "even more clearly in order." *Udall v. Tallman*, 380 U.S. 1, 16 (1965); *see also Auer*, 519 U.S. at 461 (same).

That is precisely the case here. Regulation Z is the Federal Reserve Board's implementing regulation with respect to the definition and categorization of different consumer credit transactions, including finance charges and other charges related to credit card transactions. The regulation expressly excludes over-limit fees from its definition of finance charges. *See* 12 C.F.R. 226.4(c)(2). This position is further reinforced by the Official Staff Commentary explaining the provisions of Regulation Z, which also requires over-limit fees to be disclosed as "other charges" on initial and periodic disclosures. *See* 12 C.F.R. Part 226 Supp. I, Official Staff Interpretations, Cmts. 6(b)-1(i), 7(h)-4.



Not only does this case implicate the standard rule of *Chevron* deference, therefore, but it also invokes the Court's emphatic holding that staff opinions of the Federal Reserve Board should be found to be controlling on the appropriate interpretation of the TILA and of the implementing regulations that the agency administers. In *Milhollin*, the Court expressly held that "[u]nless demonstrably irrational, Federal Reserve Board staff opinions construing the Act or Regulation should be dispositive for several reasons." 444 U.S. at 565. First, as stated above, the Court "has often repeated the general proposition that considerable respect is due 'the interpretation given a statute by the officers or agency charged with its administration.'" *Id.* at 566 (quotation omitted). Second, Congress has "specifically designated the Federal Reserve Board and staff as the primary source for interpretation and application of [this consumer protection] law." *Id.* Third, deference to the agency "is compelled by necessity," since "a court that tries to chart a true course to the Act's purpose embarks on a voyage without a compass when it disregards the agency's views." *Id.* at 568.

Because the TILA gives the Board and its staff such unusually "broad administrative lawmaking power," *Milhollin*, 444 U.S. at 566, this Court has noted that Congress has stated its decisive "preference for resolving interpretive issues [under the TILA] by uniform administrative decision, rather than piecemeal through litigation," in order to produce the "coherent and predictable body of administrative rules" demanded by this complex statute. *Id.* at 568 & n.12. Indeed, in *Milhollin*, this Court squarely held that the Federal Reserve Board and its staff must be treated as one and the same for purposes of affording judicial deference:

> But to the extent that deference to administrative views is bottomed on respect for agency expertise, it is unrealistic to draw a radical distinction between opinions issued under the imprimatur of the Board and those submitted as official staff memoranda. . . . At any rate, it is unnecessary to explore the Board/staff difference at length, because Congress has conferred special status upon official staff interpretations. *See* 15 U.S.C. § 1640(f); 12 C.F.R. § 226.1(d) (1979).

*Id.* at 566 n.9. Accordingly, "judges ought to refrain from substituting their own interstitial lawmaking for that of the Federal Reserve, so long as the latter's lawmaking is not irrational" under the provisions of the TILA. *Id.* at 568.

The court below declined to give deference to the Board and its implementing regulation in this case, primarily because it thought itself obliged to apply a different rule of construction. In particular, the court below explained that based on the TILA's core purpose of protecting consumers in credit transactions, the statute must be construed liberally in the consumer's favor. The *amicus curiae* agrees that this is an important guidepost for determining close questions about the proper interpretation and application of the TILA. It is, indeed, a pertinent canon of construction that illuminates the meaning and purpose of all such consumer protection statutes, and it should be employed to guide both the Board and the courts in situations that are governed by their terms. *See, e.g., Milhollin*, 444 U.S. at 559 (TILA's purpose is to assure "meaningful disclosure of credit terms to consumers"); *Mourning*, 411 U.S. at 371 (same). *Cf. Blue Shield of Va. v. McCready*, 457 U.S. 465, 472 (1982) (construing antitrust laws in light of Congress' "expansive remedial purpose" to protect and benefit consumers); *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967) (in construing the Securities Exchange Act, "we are guided by the familiar canon of statutory construction that remedial legislation should be construed broadly to effectuate its purposes").

But the error here is that canons of construction cannot be employed to trump the judicial deference to agency action that



is mandated by the Court's consistent line of precedents running from *Chevron* to *Mead* and down to the present. To the contrary, *Chevron* teaches that *only* where the statute reflecting "the intent of Congress is clear, that is the end of the matter." *Id.*, 467 U.S. at 842-43. But where the statute is "silent or ambiguous," *id.* at 843 — as is so, by definition, where the courts must turn away from the statutory text itself to seek interpretive guidance from canons of construction, *see, e.g., Hassett v. Welch*, 303 U.S. 303, 313-14 (1938) ("Resort is had to canons of construction as an aid [when the statute has] sufficient ambiguity to warrant our seeking such aid.") — then controlling precedent dictates that the Board's construction of the statute must control, especially where, as here, a uniform administrative construction is essential to weaving a coherent web of federal regulations to govern all consumer credit transactions. *See, e.g., Milhollin*, 444 U.S. at 559-60.

Congress's actions and the Court's precedents thus establish a decisive preference for uniform administrative construction of the TILA rather than piecemeal decisionmaking through the lower courts. The Court has since reaffirmed the same directive that courts must defer to the Board's authority in *Valencia*, a case involving the disclosures required on an installment contract to purchase an automobile: "as we so plainly recognized in [*Milhollin*,] absent some obvious repugnance to the statute, the Board's regulation implementing this legislation should be accepted by the courts, as should the Board's interpretation of its own regulation." *Valencia*, 452 U.S. at 219.

Accordingly, in this case, as in *Chevron* and *Milhollin*, "the Court of Appeals misconceived the nature of its role in reviewing the regulations at issue." *Chevron*, 467 U.S. at 845. Once the courts have discerned that Congress did not speak specifically and explicitly in the TILA to the question whether over-limit fees are finance charges rather than other permissible charges, the only remaining issue is whether the agency's own views on that subject are merely "reasonable" — and if so, they must be upheld. *Id.*; *see also Mead*, 533 U.S. at 227-31.

### C. The Court's Reasons for Requiring Deference Are Sound and Fully Applicable Here.

Although the Court has not revisited the proper relationship between the courts and the Federal Reserve Board under the TILA for more than two decades, the original rationale for granting substantial judicial deference to the Board remains sound. As an initial matter, the Court had noted the complexity of the matters covered by the statute and the consequent importance of a uniform administrative interpretation of the statutes governing consumer credit transactions throughout the country. *See, e.g., Milhollin*, 444 U.S. at 566-68.

In the years since the Court's decisions in *Mourning* and *Milhollin*, the justification for this approach has only become more compelling. In the last twenty years, there has been an explosion of consumer credit transactions of all kinds, including, in particular, the kinds of credit card transactions at issue in this case. The amount and kinds of credit that are routinely extended to ordinary consumers now dwarfs the nature of the industry in the 1970s. In addition, the extension of the TILA to consumer leases has brought under its ambit an entirely new range of credit transactions, including leases and lease-to-own purchases such big-ticket items as automobiles and other consumer durables. *See* Consumer Leasing Act, 90 Stat. 259 (1976), 15 U.S.C. § 1667 *et seq*. The banking and finance industries also have become increasingly national in scope in recent decades; whereas thirty years ago much of that regulation occurred on a state-by-state basis, the Federal Reserve Board has since assumed a much greater role in ensuring the soundness of financial institutions and regulating their practices with respect to both business creditors and individual borrowers.

The sheer magnitude of consumer transactions covered by the TILA, which has greatly expanded even since the Court decided *Mourning* and *Milhollin*, thus reinforces the basis for the Court's steadfast determination to require judicial deference to the Board's exercise of its expert regulatory authority. As the Court has cogently stated: "Because of their complexity and variety, however, credit transactions defy exhaustive regulation



by a single statute. Congress therefore delegated expansive authority to the Federal Reserve Board to elaborate and expand the legal framework governing commerce in credit." *Milhollin*, 444 U.S. at 559-60. The categories of transactions now range from the credit card transactions whose regulation is under review here — involving virtually all consumers — to the motor vehicle leases at issue in the *Schlenk* case, which by themselves now constitute a multi-billion-dollar industry. Congress's acknowledged "preference for resolving interpretive issues [under the TILA] by uniform administrative decision, rather than piecemeal through litigation" is thus all the more essential, in the wake of these developments, in order to produce the "coherent and predictable body of administrative rules" demanded by this complex statute. *Milhollin*, 444 U.S. at 568 & n.12.

## II. THE RULE OF DEFERENCE THAT THE COURT HAS ESTABLISHED IS EVENHANDED, FOR IT BENEFITS PLAINTIFFS IN SOME CASES AND DEFENDANTS IN OTHERS.

The propriety of the settled rule of judicial deference to the Federal Reserve Board in these types of cases is underscored by the evenhandedness of the rule. There is no particular pattern to which parties — plaintiffs or defendants — can be expected to benefit by this approach in any given case. That is as it should be, for the Board plays an entirely impartial role as a regulatory body. It carries out its prescribed function, which is authorized and mandated by Congress, through its adoption of neutral administrative rules that it judges to be most faithful to the text and purpose of the TILA. The Board itself must be evenhanded insofar as it balances the rights and interests of consumers against those of the vendors and providers with whom they transact business. The Board also supplements its rules with official staff commentary that clarify and elaborate in more detail — based on its specialized expertise — how and why its regulations apply to different transactions and scenarios involving consumer credit.

As shown by the contrast between the circumstances of this case and the facts of the *Schlenk* case, a consistent rule of

judicial deference to agency expertise and delegated congressional authority does not uniformly favor either plaintiffs or defendants, consumers or vendors. In this case, for example, it happens to be the credit card companies who seek the benefit of the Board's interpretation of the TILA, since the Board has determined that over-limit fees are not "finance charges" within the meaning of 15 U.S.C. § 1605(a), but more appropriately are defined to fall within the "other charges which may be imposed" on the account under 15 U.S.C. § 1637(a)(5). According, the Board's interpretation of the TILA happens to disserve the interests pressed by the individual consumer in this case. In *Schlenk*, by contrast, it is the motor vehicle lessor that is fighting the Board's interpretation of the statute, and the individual consumer who seeks to uphold it. There the Board has correctly determined that "acquisition fees" (a type of handling charge that is imposed on many motor vehicle leases) must be disclosed on the face of the lease, but the lower court (as in this case) declined to defer to the Board's construction of the TILA and of its own implementing rules, hewing instead to its own preferred reading of statutory and regulatory provisions that cannot fairly be regarded as unambiguous.

The same evenhandedness in applying the rule of deference is apparent from the Court's few decisions involving the TILA. In *Mourning*, the first case in which the Court addressed the provisions of this statute, an individual consumer who contracted to buy some magazine subscriptions sued because she believed the company had failed to comply with the terms of Regulation Z — the same regulation at issue in the present case. As happened here, the district court upheld Regulation Z, but the court of appeals reversed, holding that the Board had exceeded its statutory authority under the TILA by adopting the relevant provisions of the regulation. *See id.*, 411 U.S. at 358-63. In *Mourning*, the defendant company argued that the TILA only mentions disclosure in regard to transactions in which a finance charge is imposed, but Regulation Z as adopted would apply even to transactions where no such charge exists. This Court rejected the argument, however, noting that Congress did not attempt "to list comprehensively all types of transactions to



which the Board's regulations might apply," but instead conferred a "broad grant of rulemaking authority" to capitalize on the expertise and other beneficial "attributes of agency administration." *Id.* at 372-73. The Court therefore reversed the decision below and ruled in favor of the consumer.

When the next case involving the TILA came to the Court a few years later, the shoe was on the other foot. In *Milhollin*, the suit was brought by individual consumers who had purchased their automobiles through installment contracts. They contended that the defendant, a motor vehicle finance company, had violated the TILA by failing to disclose on the front page of the contract that the creditor retained the right to accelerate payment of the debt in certain circumstances. The lower courts had ruled in favor of the consumers, based on their interpretation of the TILA and of Regulation Z, which once again was at issue there. *See id.*, 444 U.S. at 557-59.

This Court reversed, concluding that neither the statute nor the regulation clearly resolved the issue. In that situation, "judges are not accredited to supersede Congress or the appropriate agency by embellishing on the regulatory scheme." *Id.* at 565. Instead, they must defer to the agency's own views, even as expressed in "Federal Reserve Board staff opinions construing the Act or Regulation," which "should be dispositive" unless they are "demonstrably irrational." *Id.* In *Milhollin*, it turned out that this approach favored the finance company defendant, since the Board and its staff had consistently interpreted the statute and regulations to impose no such uniform requirement of disclosure. *See id.* at 562-70.

The same evenhanded results show up in other lower court cases as well. *Compare Benion v. Bank One*, 144 F.3d 1056, 1059 (7th Cir.) (ruling granting deference to Board favored defendant bank because "consumer credit disclosures are comprehensively regulated by the Federal Reserve Board . . . [and] courts should generally leave the plugging of loopholes to the agency, lest the court's reparative efforts create confusion and disrupt the regulatory scheme") (citing *Milhollin*), *cert. denied*, 525 U.S. 963 (1998) *with Riviere v. Banner Chevrolet,*

*Inc.*, 184 F.3d 457, 460 (5th Cir. 1999) (ruling granting deference to Board favored plaintiff consumer because "Congress 'delegated expansive authority to the Federal Reserve Board to elaborate and expand the legal framework governing commerce in credit'") (quoting *Milhollin*).

In the end, the settled approach of great judicial deference to the Board's interpretation of its own governing statutes and regulations is right because it reflects the appropriate relationships among the three branches of the Federal government. In this field, as in many other areas where the Congress has enacted general statutes and expressly authorized administrative agencies to fill in the details by applying their expertise to the intricate regulatory questions that must arise in everyday life, the questions are technical and practical rather than rigidly ideological. Under the TILA, in particular, as the case law shows, the Federal Reserve Board and its staff have enforced no systematic policy that favors plaintiffs or defendants, consumers or vendors. In any situation where reasonable interpreters of the governing statutes and regulations could differ, therefore, the Board's own views are entitled to substantial deference from the courts.

## CONCLUSION

The decision below should be reversed.

Respectfully submitted,

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